Tax Reform Update: What Tax-Exempt Health Care Providers Need to Know

On December 22, 2017, President Trump signed into law the most comprehensive overhaul of the tax code in decades. Although benefiting for-profit organizations with a cut in the corporate tax rate, the reform is less favorable to tax-exempt organizations such as hospitals, health systems and other health care providers. With the new tax law, exempt organizations face new challenges in unrelated business income tax ("UBIT"), tax-exempt bonds, and executive compensation among other things. As noted below, with the new tax law, exempt organizations face new challenges.

1. **Netting of UBIT Profits and Losses.** Even if an organization is tax-exempt, it may still be liable for business income unrelated to its exempt purpose. Effective as of January 1, 2018, tax-exempt organizations will not be able to offset losses from one unrelated business against income of another. Although this may result in additional tax liability for tax-exempt organizations that previously netted unrelated business gains and losses across the organization, the silver lining is that UBIT will be at the now lower corporate tax rate.
2. **Private Activity Bonds.** A previous House bill threatened to end tax-exempt bond financing known as private activity bonds which are a critical source of funding for exempt health care providers. In the final version of the new tax law, this provision was removed—but bond financing did not come out wholly unscathed. The new law repealed the exclusion from gross income of interest on advance refunding bonds. This means that exempt borrowers will need to wait to refinance existing bonds until the bond is callable or incur additional tax liability.
3. **Excise Tax on Executive Compensation.** The tax reform's greatest impact to large exempt entities such as hospitals and health systems may be found in the new excise tax on executive compensation. Under the new law, exempt organizations are liable for a 21% excise tax on compensation above one million dollars paid to "covered employees." Included in the definition of "covered employees" are the organization's five highest-paid employees in the taxable year, as well as all covered employees for any preceding tax year that began after 2016. Luckily for health care providers, the excise tax on executive compensation does not apply to payment for a

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licensed medical professional to perform medical services. The new law also prevents an exempt organization from moving employees to a for-profit parent or subsidiary to avoid the excise tax; however, exempt organizations may be able to utilize service or management agreements with separate entities to avoid increased tax liability in some circumstances.

The professionals at Reinhart Boerner Van Deuren s.c. are available to assist you in reviewing your options and developing strategies to address the financial burdens created by the new law as well as how to minimize tax liability. Feel free to contact Larri Broomfield or your Reinhart attorney, to discuss any questions or concerns related to your health care organization.