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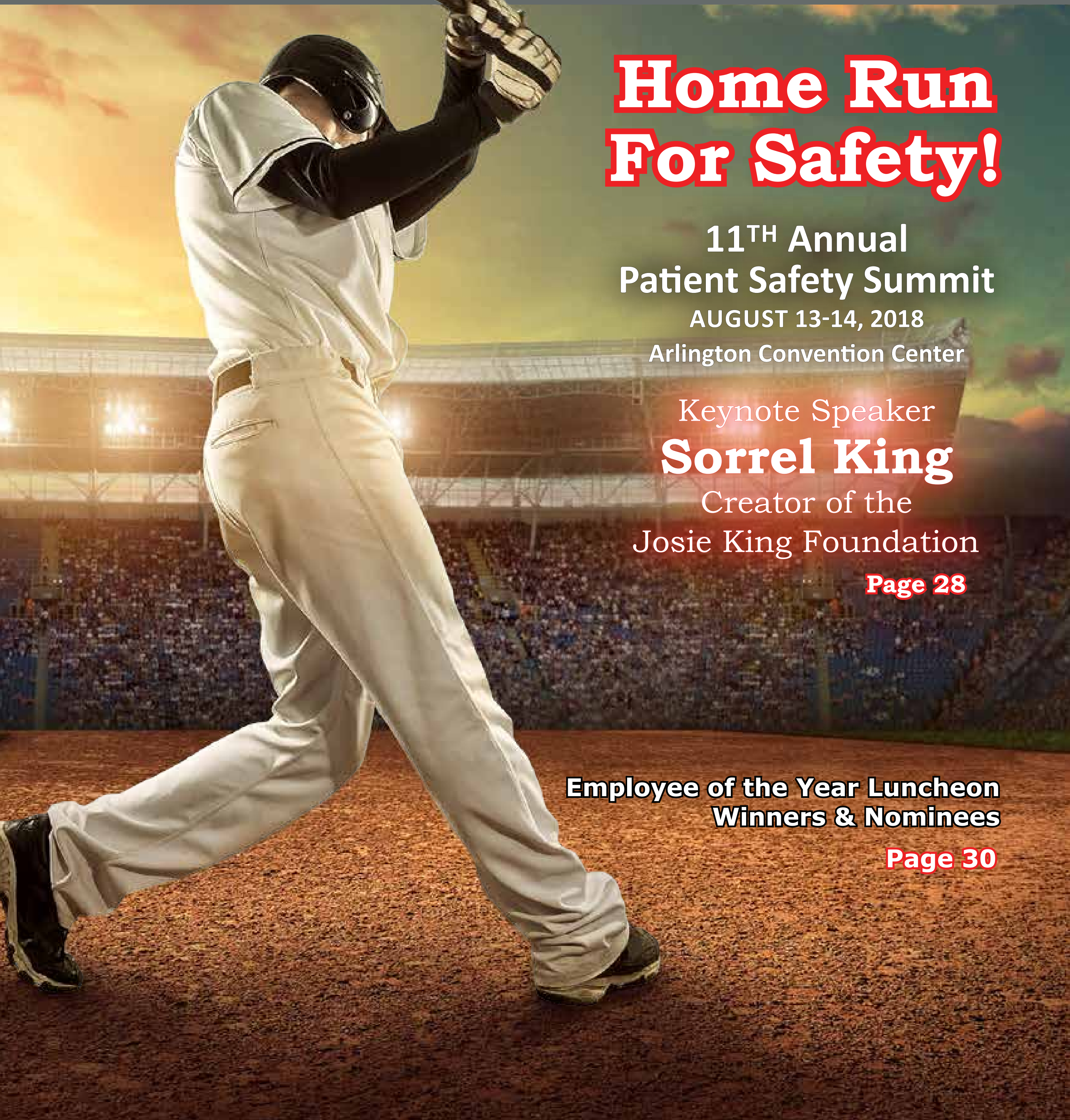

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Employee of the Year Luncheon Winners & Nominees

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TAX REFORM BILL:

Takeaways for Healthcare Practitioners

By Evie Lalangas and Dan Kroll, Gray Reed & McGraw LLP

THE NEW TAX REFORM BILL SIGNED BY PRESIDENT TRUMP at the end of 2017 (the "Tax Act") has many taxpayers wondering what its exact effects will be. For healthcare professionals, doctors included, there are several relevant provisions to understand. The first significant change is the personal income tax bracket adjustments.

Prior law had graduated tax rates ranging from 10 percent to 39.6 percent. The Tax Bill lowered bracket thresholds and rates, which now range from 10 percent to 37 percent, lowering the highest tax rate by almost 3 percentage points. Notably, these new brackets and rates expire after 2025. Although personal exemptions for individuals are eliminated, standard deductions have doubled.

The standard deduction is now $12,000 for individual taxpayers and $24,000 for married couples filing joint returns. The Tax Act also limits the amount of property taxes and state and local income taxes that may be deducted. For physicians, who typically have higher incomes, the takeaway here is that their overall tax burden may actually increase as a result of the Tax Act.

For providers who own their practice, there are certain advantages and disadvantages of the Tax Act law to note resulting from the form of business entity in which the provider operates. One of the most publicized pieces of the Tax Act is the overall reduction in the corporate tax rate which is now at a flat 21 percent - a significant cut from prior rates which ranged from 10 percent up to 35 percent. However, this rate reduction must be balanced with the change to interest expense deductions as prior law allowed for a full deduction of interest payments, but the Tax Act caps interest deductions to 30 percent of EBITDA (earnings before interest, taxes, depreciation, and amortization).

Some analysts have projected that this may raise net taxes after 2017 as well as increase the cost of borrowing by highly leveraged businesses. In addition, the Tax Act provides for a "pass-through" deduction of up to 20 percent of qualifying business income for "S Corporations", limited liability companies, partnerships and sole proprietorships.

For physicians with taxable income in excess of $157,500 ($315,000 if married), this deduction for income from providing medical services will be phased out over a range of $50,000 ($100,000 if married) and completely eliminated at $207,500 ($415,000 if married). For other income of those physicians from pass-through entities which is not attributable to the provision of medical services, the deduction related to such income will likely be limited by complex calculations based on the amount of W-2 wages the entity pays to non-owners and the amount of capital invested by the entity.

Private practitioners should review these changes with their counsel, since the lower corporate tax rate might encourage a practice to restructure as a corporation from a pass-through entity. The advantage of a corporation that

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is not an "S Corporation" is that for providers who do not qualify for the pass-through break, the top income-tax rate would be at the personal level – which would be at most 37 percent. However, corporate status would still subject the practice entity to double taxation, meaning income would be first taxed at the entity level a rate of 21 percent, with any dividends being taxed to the individual at their personal tax rate.

Caveats abound – switching entity types could be a taxable event and may cost more money than necessary in the long run, and elective entity classification changes are permitted only once every five years.

The Tax Act significantly increased bonus depreciation for personal property (i.e., medical equipment) from 50 percent to 100 percent for several years before it will decrease to zero. Importantly, bonus depreciation now applies to used property rather than only new property. Physician practices acquiring qualifying property may be able to immediately deduct 100 percent of the cost in the current tax year rather than taking depreciation over several years.

Physicians employed by a tax-exempt entity, such as a hospital, could see a significant change in compensation schemes. For tax years beginning January 1, 2018, a tax-exempt organization (including many hospitals) will have to pay an annual excise tax of 21 percent on compensation over $1 million to "covered employees". There are several caveats:

- The excise tax does not apply to payments made to a licensed practitioner for their professional, medical services;
- A "covered employee" includes the five highest paid current (or former) employees for a particular tax year. It also includes any former employees from 2016 onward who still receive post-termination payments, meaning the number of "covered employees" may not actually be limited to five per year;
- Compensation subject to the excise tax includes cash compensation, deferred compensation, and parachute payments to any top five employee in excess of three times the five-year average of their total compensation;
- For hospitals with a layered system, this tax applies at each entity level. So, if two tax-exempt entities within a hospital system have five or more employees compensated $1 million or more each, compensation payments to all of these employees would be subject to the excise tax.

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Although the excise tax is not imposed on the individual employee, it may force tax-exempt entities to review their corporate structure and payment schemes, potentially hamstringing talent acquisitions and increasing attrition rates. Tax exempt entities are now at a distinct disadvantage in obtaining physician services when compared to for-profit entities which do not have to pay a tax on their highest paid employees.

Finally, and possibly to the chagrin of many Democrats, the Tax Act also eliminated the penalties on individuals without health insurance mandated by the Affordable Care Act ("ACA"). Also known as "Obamacare", the ACA imposed a penalty on individuals without health insurance that increased as each year passed. It was most recently set at the higher of $695 or 2.5 percent of household income.

This change may affect providers, particularly primary care practitioners, since data has shown an uptick in patients generally seeing primary care practitioners and using health services due to the ACA's expanded coverage access. Similarly, hospital systems experienced a reduced amount of uncompensated care or charity care that was otherwise written off since the overall number of insured individuals was on the rise. It will take at least a year or two to note any difference in uninsured patient levels attributable to the elimination of this penalty.

The new tax law is multi-layered and still being absorbed by experts and the public alike. As such, this article is not an exhaustive recap of the tax law provisions that will affect physicians. We recommend meeting with an attorney for assistance.

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