HOOPER LUNDY BOOKMAN

Congress Passes Sweeping Tax Reform Bill

Insights

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This week, the U.S. Senate and House of Representatives passed the *Tax Cuts and Jobs Act* (the Act), which now heads to the President's desk for his signature. In addition to significant changes affecting individuals, the Act includes numerous changes that may have important impacts for the operations of both nonprofit and for-profit health care entities. Most provisions are effective for tax years beginning after December 31, 2017. Below is a summary of key provisions.

- **Health Reform and the Affordable Care Act**:
  - **Repeal of the Individual Mandate.** The Act repeals the individual mandate effective January 1, 2019, but leaves other ACA provisions in place, including the market reforms, patient protections, and employer mandate. The individual mandate is a core component of the ACA, designed to control adverse selection and expand the risk pool on the individual health insurance market by penalizing those that fail to obtain coverage. The elimination of the mandate may affect the stability of the individual and small group health insurance markets, including Marketplaces like HealthCare.gov and Covered California. The Congressional Budget Office has estimated that, the repeal of the individual mandate may cause between 4 and 13 million individuals to lose coverage and that premiums on the individual and small group markets may rise about 10 percent. The earliest indicator of the impact of the elimination of the individual mandate will likely be effectuated Marketplace enrollments in 2018. The 2018 Open Enrollment Period for federally facilitated Marketplaces has closed, but many consumers have not "effectuated" their enrollment by paying their January premiums. If more consumers than usual fail to effectuate enrollment, this would suggest decreased consumer interest in coverage without the mandate. In addition, the open enrollment period in California and a handful of other states is ongoing, and consumer behavior in these states over the coming weeks will provide another early indicator of the impact of the individual mandate's elimination. Together, this data will likely influence premium rating and insurer participation in the individual market in 2019.
- **Tax Policies Impacting Nonprofit Entities**:
  - ***Excise Tax on Executive Compensation.*** Tax-exempt organizations will now be subject to a 21 percent excise tax on any compensation paid to "covered employees" that exceeds $1

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million. Subject to some exceptions, "covered employees" consists of the five highest-paid current or former employees in any given year. The tax applies to both current compensation and deferred compensation. Importantly, the excise tax applies whether or not an organization has complied with the rebuttable presumption procedures that exist within the intermediate sanction rules. The intent of the change is to place nonprofits in the same position as publically-held companies, however the change may negatively impact nonprofit organizations' ability to compete with private, for-profit entities that are not subject to this restriction.

  - ***Excise Tax on "Parachute Payments."*** A 21 percent tax for covered employees also applies to severance payments made to departing executives to the extent that the total "parachute payments" exceed three times the five-year average total compensation for that individual.
  - ***Unrelated Business Income.*** The Act includes changes to the way in which tax-exempt organizations calculate unrelated business income (UBI). Tax-exempt entities are no longer permitted to aggregate profits and losses from various unrelated business in connection with the calculation of the UBI tax liability.
  - ***Charitable Donations.*** The Act roughly doubles the standard deduction for individual taxpayers and increases the estate tax threshold. Both of these changes may decrease charitable donations to tax-exempt organizations. The Act raises the adjusted gross income limitation for contributions to operating charities from 50 percent to 60 percent.
  - ***Private Activity Bond Financing Not Impacted, Advance Refunding Bond Eliminated.*** The House version of the Act passed in November included a provision that would have prospectively eliminated tax-exempt private activity bond financing for 501(c)(3) organizations. The repeal would have been particularly challenging for California hospitals in need of capital to address seismic-compliance related concerns. To the relief of many tax-exempt organizations, the provision was not included in the Act, however, the Act does include a provision that eliminates advance refunding bonds.

- **Tax Policies Affecting For-Profit Entities**:
  - ***Reduction of Corporate Rate***. The Act reduces the federal corporate tax rate to 21 percent (down from 35 percent).
  - ***Corporate Alternative Minimum Tax***. The Act eliminates the corporate alternative minimum tax.
  - ***100% Expensing of Capital Investment and Limits on Deductibility of Net Interest Expense***. The Act allows businesses to immediately expense (as opposed to depreciate) capital investments made in the next five years. This provision phases down in subsequent years. This policy will provide a meaningful tax incentive for new equipment purchases. Conversely, limits on the deductibility of net interest expense may discourage some debt-financed activity.
  - ***Net Operating Losses ("NOLs")***. The Act modifies the treatment of NOLs so that NOLs are now limited to 80 percent of taxable income, with no carrybacks and with unlimited carryforwards.
  - ***Pass-Through Income Deduction***. In addition to a general reduction in individual statutory rates, the Act includes a 20 percent deduction on pass-through (sole proprietorships, subchapter S corporations, LLCs and partnerships) income for some businesses in certain trades and subject to various restrictions and limits. For example, the deduction is limited for specific service industries that provide health, law and professional services.

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