Tax Update for Healthcare Financial Executives

Carolinas HealthCare System
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Agenda

- IRS Priority Guidance Plan: Fiscal Year '16
- 501(r) – Additional requirements for hospitals: Practical considerations
- Other tax considerations in implementing the ACA: UBI, Excise Taxes
- Executive compensation and benefits update
- ACA update
- Questions

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IRS Priority Guidance Plan: Fiscal Year '16

IRS Priority Guidance Plan: Fiscal Year '16

- Faster processing / efficiencies:
  - Form 1023-EZ for small, simple exemptions (done)
  - Determination of exempt status improved from 1.5 years to under 6 months (done)
  - Continuing to refine 990 e-File format for better automation
  - Determination cases closed in 35 days (down from 90) if no response (quicker response required from taxpayers)
  - Refining information document requests

IRS Priority Guidance Plan: Fiscal Year '16

- Employee Plans
  - Focus on Employee Plan Team Audit (EPTA)/Large Case, multiemployer plans, IRC 403(b)/457(f) plans – Historical pattern of non-compliance
  - Employee Plans Compliance Unit (EPCU) – Focus on non-compliance in plan operation/form. New compliance checks to come
  - Voluntary Compliance (VC) program to continue

IRS Priority Guidance Plan: Fiscal Year '16

- Exempt Organizations focus areas:
  - **Exemption** (non-exempt purpose, private inurement)
  - **Protection of Assets** (self-dealing, excess benefits, loans to disqualified persons)
  - **Tax Gap** (employment tax, UBI)
  - **International** (funds spent out of US, potential terrorist funding, operating as foreign conduit, FBAR)
  - **Emerging Issues** (IRC 501(r), non-exempt charitable trusts)
- Expect:
  - Data analysis of Form 990
  - Correspondence and field exams

IRS Priority Guidance Plan: Fiscal Year '16

- Miscellaneous
  - 1099-Misc / Worker misclassification research project
    - payroll analysis to determine non-compliance
  - Early Retirement Incentive Plans
    - potential employment tax issues under 'constructive receipt' rules
  - Tax Exempt Bonds focus
    - Whistleblower referrals (20% of caseload)
    - Market Segment non-compliance patterns (i.e. private activity bonds, advance refunding market)
    - VCAP (Voluntary Compliance Agreement Program) continues

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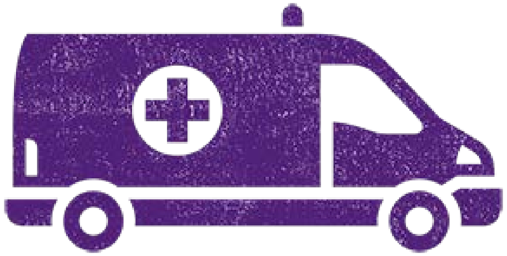
501(r) – Additional requirements for hospitals: Practical considerations

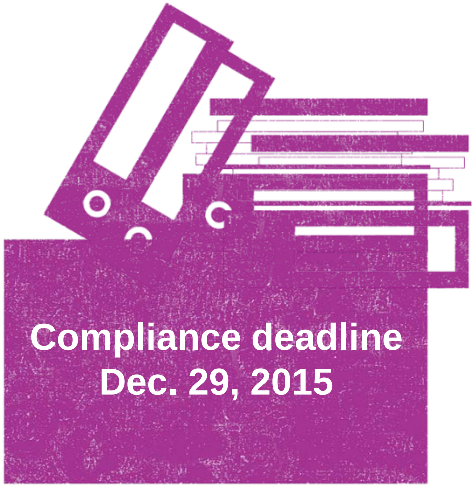
Overview of IRC §501(r)

- Required in order to maintain tax-exempt status
  - Community health needs assessment (CHNA)
  - Financial assistance policy (FAP)
  - Emergency medical care policy
  - Limitation on charges
  - Billing and collection practices



Overview of IRC §501(r)

- Effective dates of the law
  - Generally years beginning after Sept. 23, 2010 (CHNA - March 23, 2012)
- Effective dates of Final Regulations
  - Years beginning after Dec. 29, 2015



Application of IRC §501(r)

- Who must comply:
  - Each separately licensed hospital facility
    - State licensing law implications
    - Separate policies/processes
  - Not your typical acute care hospital
    - LTACH, Rehabilitation, etc.
  - Considerations for combined policies:
    - Clear identification
    - Multiple ABG computations required

Application of IRC §501(r)

- Who must comply:
  - Hospitals held in a partnership? **Yes**
    - Exceptions are limited
      - Lack of control & treated as UBI
      - Certain educational / scientific (limited)
    - Are they following your policies?
  - Governmental hospitals? **Maybe**
    - 501(c)(3) status must comply

Consequences of insufficient compliance

- Errors or omissions – Safe harbors:
  - Minor, inadvertent, reasonable cause
    - Must correct the failure promptly
  - Neither willful nor egregious
    - Must correct the failure promptly
    - Disclose failure and correction on Form 990
- Penalties:
  - Loss of exempt status for the 'hospital facility' if safe harbors not met and not promptly corrected/reported on 990-T
    - Impact on the organization as a whole?
  - CHNA failure - $50,000 (annual/only safe harbor #1 applies)

6 recommended steps
Planning now

- Compliance with the new regulations
- Scope of change:
  - Minor → Very substantial
- New work streams and communication channels
- A closer look at your existing policies and procedures

6 recommended steps

1. Form a compliance team, and assign a project manager
    - Finance
    - Revenue cycle
    - Community benefit / relations
    - Internal legal / tax
    - Compliance / internal audit
    - Others

6 recommended steps

2. Draft or redraft policies, and assign reviews to team members
   - Gap analysis
     - Policies and processes
   - Plain language version

6 recommended steps

3. Consider getting help
    - 3rd-party assistance

6 recommended steps

4. Submit the revised policies and practices to the board or authorized committee for review/approval
   - Education: Board, committees, others
   - Timing: how many drafts before final approval?

6 recommended steps

5. Research demographics, and translate the FAP as required
   - Your community may be more diverse than you thought
     - 1,000 people who speak a language other than English (or 5% if that is less)
       - Collaboration with local health departments and governments
       - Multiple languages

6 recommended steps

6. Update your website(s), and provide paper copies
   - Who is responsible for keeping your website up-to-date?
     - Any broken links?
     - Expired/out-of-date content?
   - The public and the IRS will check here first

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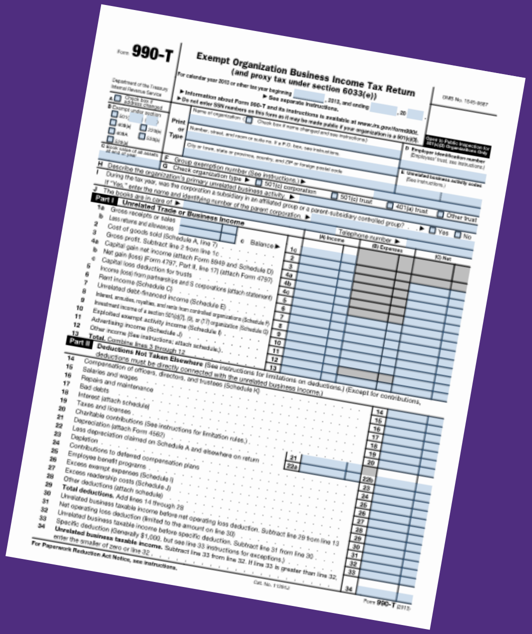
UBI Tax Considerations


Form 990-T

Exempt Organization Business Income Tax Return

(and proxy tax under section 6033(e))

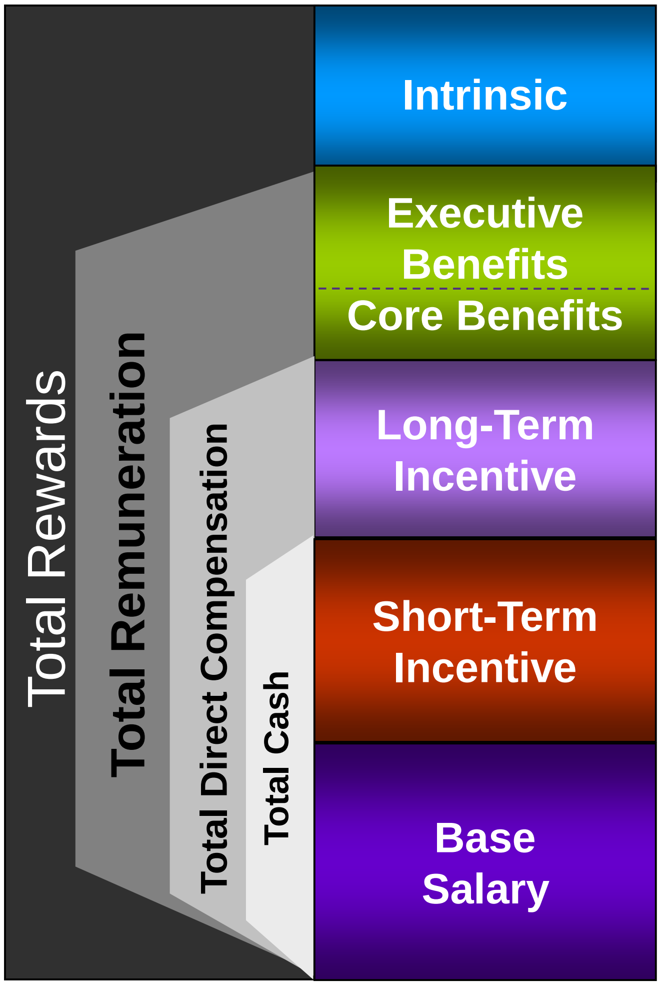
Other Tax Considerations in implementing the ACA UBI

- Management Services
- Shared Services
- Insurance/Risk Services
- Joint Ventures
- Telehealth
- Retail/Mail Order Pharmacy

Definition of a Patient

Executive Compensation and Benefits Update

Typical Executive Compensation Components



- Work environment
- Geographic location

- Supplemental executive perquisites
- Typically not at-risk based on performance

- Basic benefits competitively targeted against the market

- Total direct compensation
- Long-term incentive opportunity, typically covers 3 – 5 year period

- Short-term (annual) performance measures reviewed and approved annually
- Pay at-risk for performance

- Base salary (not at-risk for performance)
- Calibrated to target market based on job content and scope

Both decision processes and competitiveness of these elements must be consistent with applicable tax provisions

Executive Compensation Trends

Salary increases and bonuses continue to reflect the an emphasis on conservative base salary increases, but stabilizing pay for performance payouts, due to realistic goal-setting.

- Organizations are again projecting increases for 2016 at an average of 3% (consistent with the average 2015 increases)
- Organizations are budgeting incentives to pay out at target in 2015, as in 2014. Note that, unlike other industries, this is not necessarily due to simple economic improvements, but rather better ability to set appropriate goals.

Long-term incentives continue to increase in prevalence, with approximately 30% of healthcare systems offering incentives based on multi-year performance. We expect this trend to increase in the future, given the modern emphasis on long-term pay-for-performance, and the demands placed on executives as a result of health care reform.

Benefits Prevalence
Executive Benefits and Perquisites

Component	Healthcare Market	Not-For-Profit Market	Market Average
Key Executive Perquisites			
Auto Allowance	55%	74%	**64%**
First Class Air Travel	7%	39%	**23%**
Lunch/Dinner Club Membership	9%	39%	**24%**
Althletic/Fitness Club Membership	9%	-	**9%**
Country Club Membership	32%	26%	**29%**
Supplemental Group Life	95%	65%	**80%**
Executive Long-Term Disability	70%	63%	**67%**
Supplemental Retirement Plan	57%	70%	**64%**
Executive Severance Pay	43%	-	**43%**

Benefits Prevalence
Executive Benefits and Perquisites

Auto Allowance

- Generally, we find that approximately half of all organizations that provide auto allowances provide allowances that range from $800 to $1,000/month to cover all related expenses, including regular maintenance and care of the auto

First Class Air Travel

- First class air travel is generally not a prevalent benefit, however, organizations that do provide it should consider the disclosure requirements for Form 990 Schedule J as to why permitting first class travel would be reasonable and necessary, regardless of their filing status

Supplemental Life Insurance

- Typical employee benefit offering from 1 to 5 times pay, and maximums range from $750,000 to $1,000,000
- Spousal coverage typically ranges from $100,000 to $250,000
- Child life insurance benefit typically ranges from $5,000 to $10,000

Benefits Prevalence
Executive Benefits and Perquisites

Supplemental Long-Term Disability

- We typically see LTD benefits that max out at a set dollar amount, for instance $60,000 per year for all employees
  - This leaves any executive making more than $100,000 with an income replacement at less than most organizations stated goal and the general market practice of 60% income replacement
- An easy and common solution to covering any gaps in LTD coverage is to offer a supplemental LTD policy to allow employees to replace 60% of base pay in the event of a disability

Supplemental Executive Retirement/Deferred Compensation Plans

- Typically executives are provided the ability to contribute beyond the IRS limits with a supplemental plan
- Governmentals set up SERPs to target an income replacement ratio of 50-60% of the final 5-year average of base salary

Benefits Prevalence
Executive Benefits and Perquisites

Executive Severance Pay

- Typically executives are provided with severance pay in certain termination scenarios
- Generally, severance is 1 to 2 times executive's current salary

Discretionary Benefits Allowance

- In lieu of providing car allowances or other specific executive benefits, some organizations may provide an annual cash allowance
- Administratively much simpler, provides more flexibility to the executive and has better "optics" to external constituents
- This is considered part of the executives incomes and should not exceed reasonable pay

Grant Thornton Perspective On Best Practices For NFP Executive Compensation

When NFP organizations are considering elements to be included in the total rewards package for executives, its important to consider how these decisions can impact the following factors:

- **Business Purpose Rule** – Consider more than just the "how much" but also the link between total compensation and a business/mission purpose. For example, is the executive spending a considerable amount of time driving for business purposes to warrant a vehicle or vehicle allowance?
- **Form 990 Disclosures** – Make sure the supplemental disclosure of the 990 Schedule J is accurate, clear and succinct about the decision-making process
- **Stakeholder Optics Considered** – The potential implications for the disclosure of compensation elements to various stakeholders through sample or projected Form 990 disclosures should be reviewed at the time compensation decisions are made so that the Compensation Committee and Board can prepare potential responses when inquiries arrive

Grant Thornton Perspective On Best Practices – cont'd

- **Satisfy the Rebuttable Presumption of Reasonableness** – The amounts and design of total compensation opportunities provided to a broad constituency of leadership individuals (e.g., disqualified persons, key employees, others, etc…) need to be reflected upon by appropriate decision-makers, with external comparable market data available and a formalized process for recording the final decisions
- **Pay-for-performance NOT "for pulse"** – Develop integrated pay-for-performance features through different elements of the compensation program with measurable goals consistent with the strategic objectives and mission of the organization

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ACA Update

Overview of ACA Penalties

- Beginning in 2015, an applicable large employer may be subject to a penalty:
  - If the employer does not offer health care coverage to its full-time employees

Coverage Not Provided to 95%* of Full-Time Employees → **$2,000 Per Year Per Full-Time Employee**

OR

  - If the employer does offer health care coverage to its full-time employees

Minimum Essential Coverage Provided to Employees

Affordability Test
9.5% of Employee's Family Income

Minimum Value Test
Plan covers 60% of Plan Costs

→ **$3,000 Per Year Per Employee Who Receives a Credit or Subsidy from the Exchange**

* 70% in 2015

Excise tax administration

- IRS assesses the taxes based on information reported by employer
- Tax amounts adjusted for inflation, starting in 2015
- Applied on monthly basis
- Each month
  - Determine whether coverage offered to 95% or more of full-time employees (70% in 2015)
  - Determine whether coverage satisfies minimum value and affordability requirements
- Only one of the taxes applies for a given month

Excise tax administration example

Month	$2,000 tax		$3,000 tax	
	Coverage offered to 95%+?	Tax per full-time employee	Coverage affordable?	Tax per full-time employee who gets premium tax credit
January	Yes	$0	Yes	$0
February	No	$2,000 / 12	N/A	N/A
March	Yes	$0	No	$3,000 / 12
April – December	Yes	$0	Yes	$0

Full-time employees

Each month, an employer must: 1) Identify its full-time employees (30 or more average hours of service per week), and 2) determine which full-time employees have been offered coverage. *(Each new employee must be tracked separately.)*

Hours that count

- Hours for which pay is received
- Includes PTO

Hours that don't count

- Unpaid hours
- Hours outside the U.S.

average

30+

hours per week

Employer Mandate
Margin of error is low

Employers may easily fall below the 70% (95%) threshold and trigger the excise tax.

	2015		2016	
Total number of full-time employees	30% threshold	Excise tax per year	5% threshold	Excise tax per year
100	30	$40,000	5	$140,000
500	150	$840,000	25	$940,000
1,000	300	$1,840,000	50	$1,940,000
5,000	1,500	$9,840,000	250	$9,940,000
10,000	3,000	$19,840,000	500	$19,940,000
50,000	15,000	$99,840,000	2,500	$99,940,000

Excise tax may impact financial statements. Employers need to accrue for ACA excise tax when it is incurred under ASC 450, Contingencies

New IRS Forms 1094 &1095 Preparation Process

ACA Employee Tracking Software
(determine full-time status by month)

- Track paid hours
- Salaried vs. hourly
- New vs. ongoing employees
- Breaks-in-service

+

IRS form preparer
(Preparing, e-filing and distribution Forms 1094 & 1095)

- Data Consolidation
- Preparation
- Technical review
- Distribution of forms

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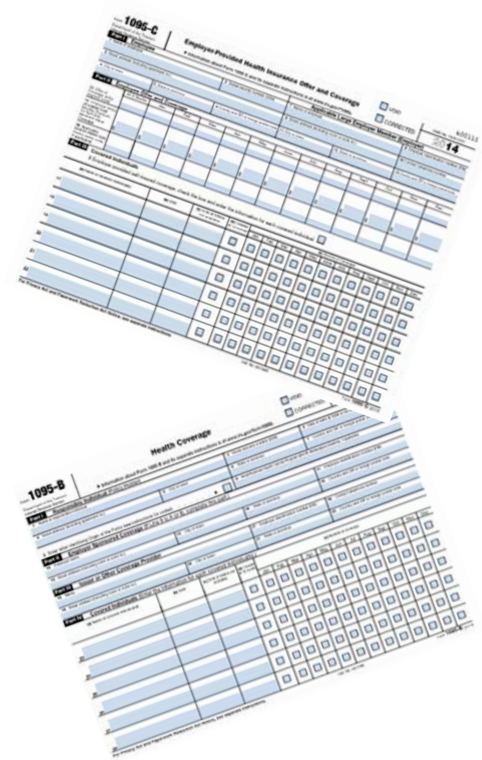
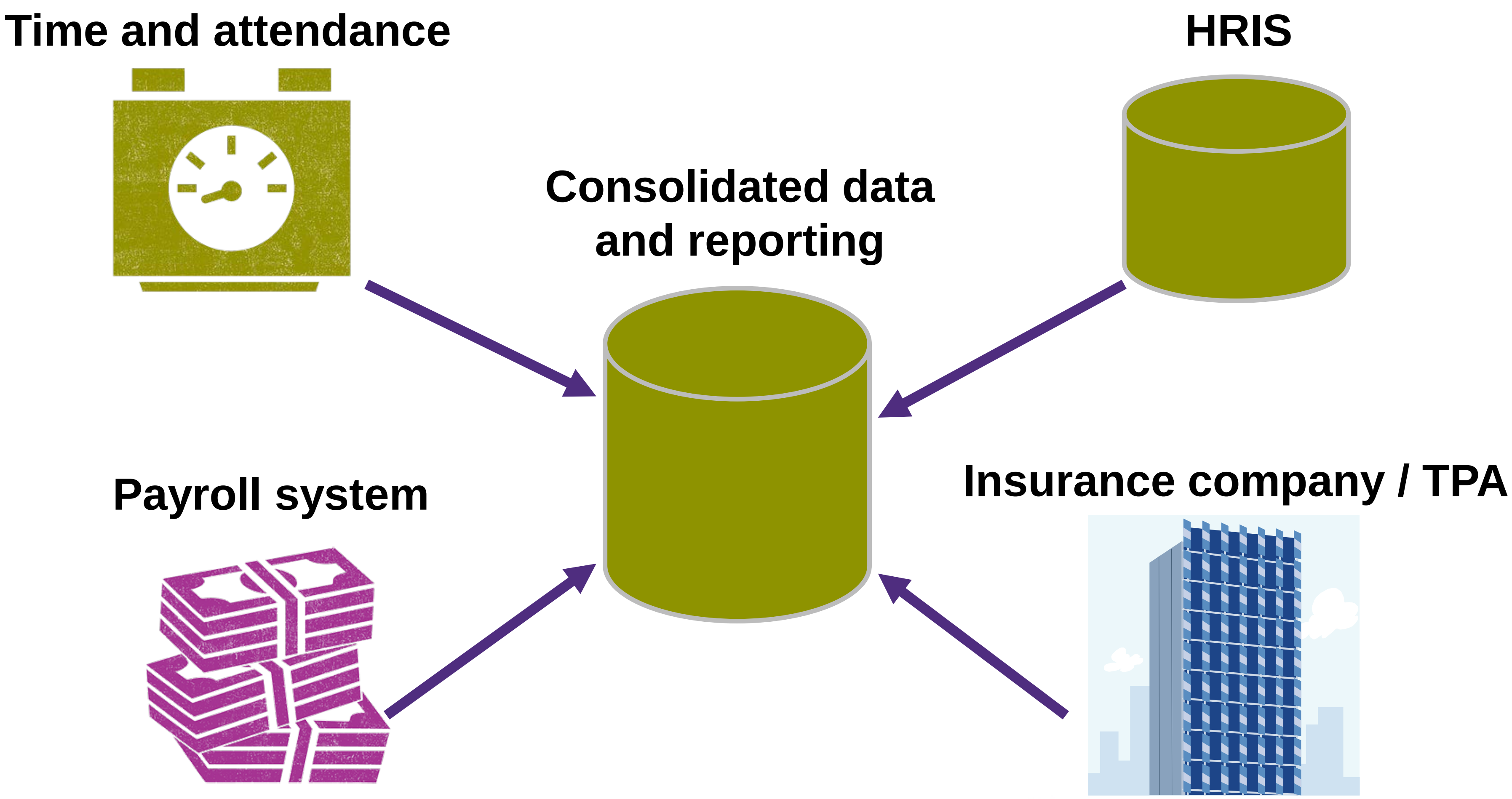


Locate where the data is stored



Excise tax on high-cost plans ("Cadillac" tax)

- Goes into effect in 2018; see Notice 2015-16
- 40% excise tax on amount by which cost of coverage for an employee exceeds threshold amount
  - Self-only coverage: $10,200
  - Other coverage: $27,500
  - Slightly higher thresholds for high-risk professions and certain retirees
  - Thresholds indexed for inflation starting in 2019

Cadillac tax – plans and costs taken into account

- All plans, including
  - Health flexible spending arrangements
  - Health reimbursement arrangements

- Excludes stand-alone dental and vision plans

- Cost amount used in calculation
  - Use COBRA rates
  - Health savings accounts: use employer contribution amount

Cadillac tax – payors

- Fully-insured plans: insurance company
- Self-insured plans: third-party administrator
- Health savings account: employer, if the employer makes contributions
- Insurance companies and third-party administrators will pass along cost to employers

Cadillac tax – examples of planning approaches

- Increase amounts paid outside the plan for health care in order to reduce plan costs
  - Deductibles
  - Co-pays

- Use cost management approaches to reduce costs
  - Wellness programs
  - Disease management programs

Questions?

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