

HEALTH CARE REFORM:
TAX-RELATED PROVISIONS FOR THE HEALTH CARE INDUSTRY

MAY 2010

The Health Care & Corporate Groups at Murtha Cullina are pleased to provide clients and friends with information about topics of interest.

If you have questions about the issues addressed in this newsletter, or any other matters, please feel free to contact any of our attorneys listed in this newsletter.

Heather O. Berchem
Marcel J. Bernier
Robert V. Giunta, Jr.
H. Kennedy Hudner
William J. Keenan, Jr.
Paul E. Knag
Mark F. Korber
Kenneth L. Levine
Michael E. McDonough
Martha Everett Meng
Elizabeth Neuwirth
Stephen E. Ronai
Alfred E. Smith, Jr.
Louis B. Todisco

In Boston:
617.457.4000
In Hartford:
860.240.6000
In Madison:
203.245.9991
In New Haven:
203.772.7700
In Stamford:
203.653.5400
In Woburn:
781.933.5505

www.murthlaw.com

This bulletin discusses tax related provisions of the Health Care Reform Laws affecting hospitals and other health care entities generally. A second installment discusses tax related issues pertaining to corporations. Both of these publications, as well as others on the Health Care Reform Laws, are available on our website, www.murthlaw.com.

Big changes are coming to the health care system, courtesy of the new Health Care Reform Laws*, and these big changes need to be funded. That means new taxes.

This Bulletin summarizes the principal new taxes and fees and the principal new tax mandates under the Health Care Reform Law. It does not address all aspects of the tax-related provisions of the Health Care Reform Law, including certain employee benefit-related provisions of the Health Care Reform Law, which are the subject of another Bulletin.

New Exemption Requirements for Tax-Exempt Hospitals.

Effective for taxable years beginning on or after March 23, 2010 except as otherwise provided below, any Section 501(c)(3) organization operating a state-licensed

hospital or otherwise having hospital care as its principal purpose or function will be required to: (1) conduct a community health needs assessment; (2) implement a financial assistance policy; (3) limit charges billed to patients who qualify for financial assistance to no more than the amounts generally billed to insured patients; and (4) observe certain limits on debt collection practices. If a health system has more than one hospital that is tax-exempt, each such hospital must meet the requirements separately to be treated as exempt from federal tax pursuant to Section 501(c)(3).

The requirement that tax-exempt hospitals provide a community health needs assessment is effective for taxable years beginning after March 23, 2012. The community health needs assessment must be performed every three years. The assessment must be made widely available to the public. It must take into account persons who represent the broad interests of the community served, including those with special

knowledge of or expertise in public health. The hospital must also adopt an implementation strategy to meet the needs identified in the assessment. Hospitals that fail to comply with the community assessment requirements for any taxable year will be subject to an excise tax penalty of \$50,000.

In order to meet the requirement that tax-exempt hospitals implement a financial assistance policy, tax exempt hospitals must have written financial assistance policies that include: (1) eligibility criteria, and whether care will be provided free of charge or at a discount, (2) the basis for calculating patient charges, (3) the method of applying for financial assistance, (4) if the hospital does not have a separate billing and collections policy, the actions the hospital may take in the event of non-payment, and (5) how the hospital will widely publicize the policy within the community served by the hospital. Hospitals must also have a written policy requiring the provision of emergency care on a non-discriminatory basis, without regard to eligibility under the hospital's financial assistance policy.

In order to meet the requirement that tax-exempt hospitals limit charges billed to patients who qualify for financial assistance to no more than the amounts generally billed to insured patients, it is intended that such charges be based on either the best, or an average of the three best, negotiated commercial rates, or Medicare rates, and that gross charges (i.e., "chargemaster" rates) not be used.

In order to meet the requirement that tax-exempt hospitals observe certain limits on debt collection practices, a hospital may not engage in extraordinary collection actions (i.e., lawsuits, liens on residences, arrests, body attachments, or other similar collection practices) before it has made reasonable efforts to determine whether the subject individual is eligible for financial assistance. The Internal Revenue Service is directed to issue guidance concerning what

attempts to determine eligibility for financial assistance constitute reasonable attempts.

New Hospital Disclosure Requirements.

Tax-exempt hospitals are required to include in their Form 990 a report describing how they are addressing the needs identified in each community health needs assessment conducted and the reasons why if all identified needs are not addressed, as well as their audited financial statements (or the consolidated financial statements in which they are included).

Treasury Review of Hospitals.

The Secretary of the Treasury is required to review the community benefit activities of each tax-exempt hospital at least every three years.

Excise Tax on Employers Who Fail To Offer Health Insurance.

For tax years beginning in 2014, if an employer (i) had more than 50 full-time employees ("FTEs") in the preceding tax year, and (ii) employs at least one person who receives a premium assistance tax credit or cost-sharing reduction for health insurance purchased from a state exchange, and (iii) fails to offer "minimum essential coverage," it will be required to pay a monthly assessable penalty of \$166.67 (\$2,000 per year) multiplied by the number of FTEs in excess of 30. If the employer does offer "minimum essential coverage," but still has at least one employee who receives a premium tax credit or cost-sharing reduction from the government, the monthly fee is the lesser of (i) \$250 (\$3,000 per year) per employee receiving the credit/ reduction, or (ii) \$166.67 (\$2,000 per year) multiplied by the number of FTEs in excess of 30.

Therapeutic Project Tax Credit.

Companies with fewer than 250 employees are eligible for a tax credit for qualified investments made in acute and chronic disease research during 2009 or 2010. The credit equals 50 percent of the qualified investment. The Department of

the Treasury, in consultation with the Department of Health and Human Services, will award certifications of eligibility for this credit.

Annual Fees on Manufacturers and Importers of Branded Drugs and Health Insurance Providers.

Beginning in 2011, manufacturers and importers of branded drugs must pay an annual fee, allocated by market share, in the amount of \$2.5 billion to \$4.1 billion (depending on the year). Beginning in 2014, health insurance providers must pay an annual fee, allocated by market share, in the amount of \$8 billion to \$14.3 billion (depending on the year).

Excise Tax on Sales of Medical Devices.

Beginning in 2013, a 2.3 percent excise tax will be assessed on the sales price of any taxable medical device sold by a manufacturer, producer or importer. Exclusions will apply for devices, such as eye glasses, contact lenses and hearing aids, generally sold to the public at retail for individual use.

Limitation on Deduction of Remuneration Paid By Certain Health Insurance Providers.

Effective for payments made in taxable years beginning after 2012, the tax deduction for compensation paid by a "covered insurance provider" to any individual who is a director, officer, employee or independent contractor for services performed that exceeds \$500,000 per year is limited to \$500,000. The limitation also applies to deferred compensation earned beginning in 2010 which is paid after 2012. Generally all corporations in the same controlled group are treated as a single employer.

Modification of Tax Treatment of Blue Cross, Blue Shield and Other Qualifying Health Insurance Organizations.

The special deduction that Blue Cross and Blue Shield organizations and other qualifying health insurance organizations are allowed under Section

833 of the Internal Revenue Code is modified to provide that these organizations will only be entitled to the special tax treatment if 85 percent or more of their insurance premium revenues are spent on clinical services.

Codification of Economic Substance Doctrine and New Penalties.

Effective for transactions entered into after March 23, 2010, to be protected from a re-characterization in which tax benefits are not recognized for federal tax purposes, a transaction entered into by an individual in connection with a trade or business or an activity engaged in for the production of income must: (i) change the taxpayer's economic position in a meaningful way (apart from federal, state and local tax effects), and (ii) have a substantial purpose (apart from federal, state and local tax effects). Transactions lacking economic substance are added to the list of situations to which the 20 percent accuracy-related underpayment penalty applies and such penalty is increased to 40 percent if the relevant facts affecting the tax treatment are not adequately disclosed. Reasonable cause defenses to the imposition of the penalty are not permitted.

*The President signed the Patient Protection and Affordable Care Act into law on March 23, 2010 and the Health Care and Education Reconciliation Act into law on March 30, 2010 (collectively, the "Health Care Reform Law").

IRS Circular 230 Notice: To ensure compliance with requirements imposed by the Internal Revenue Service, you are hereby advised that nothing contained in this communication is intended to be used, nor can it be used, for either the purpose of avoiding penalties under the Internal Revenue Code or the purpose of promoting, marketing or recommending to another party any transaction or matter addressed herein.

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BOSTON

99 High Street
Boston, MA 02110
Tel: 617.457.4000
Fax: 617.482.3868

HARTFORD

CityPlace I
185 Asylum Street
Hartford, CT 06103
Tel: 860.240.6000
Fax: 860.240.6150

MADISON

71 Wall Street
Madison, CT 06443
Tel: 203.245.9991
Fax: 203.245.9997

NEW HAVEN

Whitney Grove Square
Two Whitney Avenue
New Haven, CT 06510
Tel: 203.772.7700
Fax: 203.772.7723

STAMFORD

177 Broad Street
Stamford, CT 06901
Tel: 203.653.5400
Fax: 203.653.5444

WOBURN

600 Unicorn Park Drive
Woburn, MA 01801
Tel: 781.933.5505
Fax: 781.933.1530