Excise Tax Expansion Ahead:

Is Your Health System Ready for 2026?

The One Big Beautiful Bill Act (OBBBA) is expected to have a dramatic impact on many health systems across the country. While much of the focus has been on the impact of Medicaid eligibility reductions and other revenue implications, a change to the tax code may increase compensation costs for many health systems.

Excise Tax Rule Changes

Since the Tax Cuts and Jobs Act of 2017, health systems have had to pay excise taxes of 21% of remuneration above $1,000,000 for a group of "covered employees". The definition of this term included the five highest-paid individuals plus anyone who was in the top five group in a prior year. For purposes of the excise tax calculation, remuneration is essentially all taxable pay, excluding pay related to the provision of medical services.

Effective in 2026, the OBBBA changes the definition of "covered employees" to include all employees of the organization, not just the five highest-paid. This means that the health system must pay excise taxes for every employee with includable pay above $1,000,000. The exclusion of pay related to the provision of medical services continues to apply, so excise taxes are not expected to be incurred for most physicians paid over $1,000,000.

What's Next?

As health systems prepare for this, a first step is to understand the magnitude of the change in excise taxes. While systems with fewer than five individuals with pay above $1,000,000 may not be impacted today, they could be in the future since the $1,000,000 threshold is a fixed amount. Health systems that have multiple individuals with pay above $1,000,000 may see a substantial increase in excise taxes.

For health systems impacted by the change, the following strategies may help mitigate risk and manage costs:

1. **Review compensation program structure:** Excise tax exposure is often highest in years when executive compensation spikes – particularly due to deferred compensation arrangements or long-term incentive plan payouts. Health systems should evaluate how these plans impact excise taxes and whether modifications can help manage the tax liability while continuing to meet the core objectives of these programs. They may also consider less traditional compensation strategies – such as split-dollar life insurance – that reduce pay subject to excise taxes.

2. **Evaluate pay acceleration strategies:** With changes effective in 2026, there may be a one-time opportunity to make compensation changes in 2025. As an example, accelerating certain payments or vesting of deferred compensation into 2025 may mean those amounts never become subject to excise taxes, particularly for new covered employees.

Health systems should carefully consider the optics of such changes given increased scrutiny and the current sociopolitical environment. They should also ensure compliance with tax rules governing the acceleration of payments and should also weigh other consequences related to acceleration – including the impact on 2025 excise tax calculations, Form 990 compensation reporting implications, impact on other benefits costs tied to cash compensation, and an individual's particular tax circumstances.

3. **Review processes for determining includable pay:** In addition to identifying tax savings opportunities, health systems should ensure a sound process for determining includable pay, particularly for physicians with administrative roles. Many may have used a simplified process historically, such as reviewing remuneration levels only for physicians with administrative roles who may be in the five highest-paid group. Going forward, health systems will need to determine the portion of pay attributed to the provision of medical services for more physicians. The calculation of includable pay is critical for all covered employees and requires collaboration between those calculating excise taxes and those who understand the compensation program to ensure that certain nuances of the calculation are addressed.

With the expanded definition of "covered employees," more individuals may fall within the scope of the excise tax – potentially increasing costs. To prepare, health systems should assess their current compensation structures and consider adjustments before the rules take effect in 2026, This includes ensuring a more robust process for determining includable pay.

Looking for More?

For more information on how SullivanCotter can support your organization in navigating these excise tax changes and optimizing your compensation strategy, please reach out to us:

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