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COVID-19: Telemedicine and tax

Examining the need for tax clarity as virtual healthcare accelerates

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Telemedicine's unexpected catalyst

Telemedicine is not a new phenomenon. Yet, its popularity has never been greater.

Due to the rapid outbreak of COVID-19 and the need for social distancing, telemedicine proved to be a useful alternative to seek medical care and interact with a physician without leaving the safety of home or risking exposure to the virus in a hospital or medical office. Further boosting its appeal, the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) signed in March expanded Medicare coverage of all telehealth services, including services unrelated to COVID-19 treatment.

Despite being available for decades, the recent rise of telemedicine acceptance also thrust the need for greater clarity on tax guidance into the spotlight. Many tax questions are left up to interpretation using existing guidance and prior rulings, which sorely lack perspectives on the rapidly evolving digital landscape.

The need to act fast and provide greater clarity is increasingly evident. According to a recent Gallup poll, 18 percent of Americans surveyed in April report having virtual visits with a doctor more often than in the past. Moreover, 70 percent say they are likely to continue using telemedicine services–including 35 percent who say they are very likely--suggesting that more of these new users are being converted into permanent telemedicine patients.[1]

And it's easy to see why. In addition to being a safe healthcare option during the pandemic, its other benefits have been building slow but steady growth momentum over the years. Such benefits include lower-cost preventative care and greater convenience with less wait and travel times for patients; fewer no-show appointments and improved scheduling efficiency for medical providers; more frequent monitoring of high-risk and chronic conditions; and greater access to medical specialists for patients in remote or rural areas. In this paper, we will take a closer look at specific tax considerations as they relate to telemedicine and examine a variety of hypothetical scenarios to shed light on possible interpretations of tax outcomes.

[1] *"Increased use of low-contact services may prove permanent,"* Gallup.com, April 23, 2020.

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What's in a name?

Telemedicine. Telehealth. One in the same? Often used interchangeably, these terms have distinct meanings. Telemedicine refers to the delivery of clinical services using two-way communication technologies. Telehealth includes all health services, including medical education and public health services provided via new technologies. In some respects, telemedicine can be considered a subset of telehealth.

These terms refer to different forms of telemedicine, which may have an impact on the way guidance is interpreted.

Real-time telemedicine

Real-time telemedicine refers to a doctor-to-patient visit using any two way communication, including phone consultations or video conferencing.

Remote patient monitoring (RPM)

RPM allows healthcare providers to monitor patient's health data remotely. It's effective for high risk and chronic conditions, including asthma, diabetes, and heart disease.

Store-and-forward telemedicine

Store-and-forward telemedicine makes patient records and medical data, such as medical imaging and test results, more accessible across long distances.

Provider-to-provider telemedicine

This generally includes a consultation between specialists or between a caregiver and specialist using technologies, such as secure video conferencing platforms.

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Diagnosing the patient relationship

Since most U.S. hospitals are tax-exempt, the services they provide are not taxed if they are considered to be substantially related to their mission. However, some services may be subject to the Unrelated Business Income Tax (UBIT), if they are not seen as directly tied to the provider's mission.

Lacking updated guidance from the IRS relating to telemedicine, hospitals and other healthcare facilities must rely on existing rules governing UBIT. Some situations are easier to discern than others, leaving much open to interpretation. At the heart of the matter lies the definition of a "patient."

Drawing the critical distinction between a patient and non-patient is often essential in determining whether certain services are subject to UBIT. Once a provider establishes a patient relationship with an individual, the provider's delivery of ancillary services related to the patient's care or for that patient's convenience – such as diagnostic lab testing and pharmaceutical sales – typically does not give rise to UBIT. But providing those same services to non-patients often does give rise to UBIT.

Available authorities suggest that in-person, face-to-face interactions between an individual and a healthcare provider's employees or agents for diagnosis, treatment, or care are sufficient to render that individual a patient of the provider. As of this writing, no authorities expressly state that comparable interactions via phone consultations or video conferencing are similarly sufficient. Even more uncertain is whether a healthcare provider's monitoring of an individual's health data remotely or accessing of an individual's imaging and test results to consult with another caregiver or specialist about the individual's diagnosis or treatment could be deemed sufficient to render the individual a patient of the healthcare provider.

If activities such as remote monitoring and telemedicine consultations with other providers are determined to not themselves be sufficient to render an individual a patient, questions remain as to whether and under what circumstances such activities will give rise to UBIT. If the individual in question has established a patient relationship with the provider through other means (such as face-to-face interaction), income earned from such services is unlikely to be subject to UBIT. But if the individual does not otherwise have a patient relationship with the provider, the available authorities shed relatively little light on the correct treatment.

Does tax-exempt really mean exempt from taxes?

When practitioners refer to tax-exempt entities, they typically mean entities that are, as a general matter, exempt from federal income taxes. However, these entities may still be subject to federal income tax on their unrelated business activities. They are also subject to most types of federal employment taxes. And federal income tax exemption does not always guarantee exemption from state income tax or other types of state and local taxes (e.g., property tax).

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Tax considerations at work

Telemedicine's remote delivery of services also brings up some interesting employment tax-related considerations. As a general rule, the value of cash and noncash benefits provided to an employee by an employer is taxable income unless otherwise excluded.

How does that translate in the delivery of telemedicine, which requires items such as computers, monitors, cameras, speakers, and a variety of supplies to deliver remote services? Independent contractors would report these items on their tax return seeking a deduction for business-related expenses. However, for employees of a telemedicine service provider, it's a different paradigm.

Such expenses can be excluded from income for employees if the expense is a working condition fringe benefit under section 132 of the Internal Revenue Code. This benefit includes property or services provided to an employee, which the employee can deduct as a trade or business expense. For employees to get reimbursed, they need to include these amounts as income and they need to follow an accountable plan that explains the business reason, provides substantiation, and includes reasonable amounts. In addition to computers and other tech equipment needed for job performance, these expenses can also extend to cell phones, travel costs and, in some cases, uniforms.

Certain states may require employers to reimburse certain expenses, others do not. So from a working condition fringe benefit standpoint, the individual submits the expense and the employer may have to pay for the expenses and find a way to reimburse employees, if required by state law.

Location, location, location

Since telemedicine can be delivered from medical office locations as well as home offices, it's necessary to determine which should be used as the "tax home." If most of the time, services are delivered from a home office, it's the tax home. This is important because a home office may be in another state or tax jurisdiction, which means different withholding rules may apply.

During the COVID-19 emergency, several states provided guidance forgiving specific tax aspects of home offices, but many states have yet to follow suit as we move into the new reality, in which telemedicine will continue to be a popular means of obtaining medical care. More state guidance would be beneficial as many medical providers that did not previously practice telemedicine rushed to do so, incurring business-related expenses. Since a public emergency was declared, these additional expenses fall within section 139 of the Internal Revenue Code, which is a provision enacted during the tragic events of 9/11.

Section 139 allows individuals to give money to others to cover their additional expenses incurred as a result of the national disaster or emergency. Individuals are not taxed on the amounts they received. And in most instances, those that had given the amounts could deduct it. Employers have been using this provision for additional expenses incurred due to the COVID-19 emergency. Such expenses may include additional childcare, safety, sanitation and other expenses, such as masks, gloves, and other protective gear. Expenses related to working from home like increased utilities or home office supplies are also covered. Because this is different from the working condition fringe benefit, an individual does not need to provide receipts to get reimbursed but the amounts involved need to be considered reasonable and necessary.

Employers may also use a stipend approach where appropriate, which requires estimating reasonable expenses, documenting them and, in some cases, retaining an attestation from employees stating the expenses resulted in response to the COVID-19 emergency. The provision provides employers with the ability to act quickly and provide some economic relief to employees from the additional expenses incurred from the need to work from home.

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The CARES Act: Employee Retention Credit

For employers with more than 100 employees, the Employee Retention Credit is a provision of the CARES Act that may benefit eligible telemedicine providers. The provision permits employers to receive a 50 percent refundable credit for wages paid to employees, who are not effectively providing services. Its purpose is to help employers keep employees on their payrolls despite the economic hardship related to COVID-19.

To the extent that an employer is not providing services related to a suspension of the business, including partial suspension of the business as a result of COVID-19, they would qualify as an eligible employer. If an employer is paying employees that are idle in such instances, wages can qualify for this Employee Retention Credit.

For eligible employers in telemedicine, this scenario may apply in situations where employees, who worked and were paid for a full eight hour workday may only be working four or six hours a day. Although these employees are still providing some level of service, they are getting paid as if they provided a full eight hour workday. The credit applies to qualified wages paid after March 12, 2020, and before January 1, 2021. The maximum amount of qualified wages taken into account with respect to each employee each calendar quarter is $10,000.

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A state of tax complexity

Having employees or treating patients across state lines can trigger significant income tax considerations. For example, a tax-exempt hospital providing telemedicine services that results in UBIT will need to know state-specific tax rules. Some states do not tax UBIT but others do, so if it applies, it's necessary to figure out how to source the income between states.

This is one of many state income tax considerations that require telemedicine providers to understand intricate nexus and apportionment rules that vary widely among states. Establishing nexus reflects where a taxpayer has an obligation to file and pay taxes. The apportionment of income between states will determine the amount of taxes owed to each state based on the business conducted.

How is nexus established? It can be created by conducting or profiting from an activity that contributes to a company's overall business activity. So, even if a company has only one employee or independent contractor in another state, regardless of whether the employee is in a customer-facing role or not, it is sufficient to create nexus.

Many states have enacted laws or issued rulings that physical presence is not required to create income tax nexus after the federal ruling of the South Dakota vs. Wayfair, Inc. case in 2018. In its decision, the court determined that a sales tax collection obligation (nexus) could be established through a company's "economic and virtual" contacts with a state (economic nexus). So, in relation to telemedicine providers, the electronic transmission of services enables employees or customers to be in other states. Their location along with state-specific threshold amounts of sales, property or payroll, would be sufficient to establish nexus.

Determining nexus will depend on state-specific sourcing rules. States generally require companies to source income by using a receipts factor for the apportionment of income (a small number of states still use a payroll and property factor as well). The receipts factor sources receipts among the states using one of three general methodologies either based on where the customer is located (market sourcing), where the service is performed, or where the greater costs of performing the service occurred.

Many states have adopted market-based sourcing rules for services, which look to the location of the customer or where the benefit of the service is received (e.g., California) or where the service is delivered (e.g., Kentucky, Massachusetts, North Carolina, and Tennessee). These latter states divide service receipts into three service delivery types: in-person, electronic transmission and professional services.

Other use more traditional cost-of-performance sourcing rules for sales by looking at where the greatest amount of income-producing activity occurs. However, some states such as Florida, have reinterpreted their income producing activity test to be more of a market-type test, which focuses on customer location.

With so many different approaches, it's important to understand that marking sourcing is a not one-size-fits-all exercise. Each state has different rules. And depending upon the state, the same transaction can be sourced differently in multiple states.

There's no place like home

The need to work from home in response to the COVID-19 emergency declaration is not necessarily subject to the same tax consequences normally applied to home offices.

Several jurisdictions including New Jersey, Pennsylvania, and Washington DC have issued guidance related to employees working from home due to COVID-19, citing that stay-at-home orders will not create nexus or change the sourcing of income.

However, these special rules may not apply for existing telemedicine providers of telemedicine that are not operating electronically as a direct response to the COVID-19 emergency situation.

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Indirect tax considerations

While medical services are generally not subject to sales and use tax, the technologies that telemedicine providers use to deliver medical services can be.

Telemedicine may include multiple parties in the delivery of services including patients, health plans, corporate customers, and medical providers as well as the owner of the technology platform used in the delivery of services. Many of these parties may be in different locations, triggering potential sales and use tax implications.

Some technologies assist in the actual delivery of care, such as applications that facilitate direct messaging with licensed providers or other telemedicine interactions. Other technologies may simply provide back-end services, such as data analytics on health outcomes. So, what is taxable?

Some jurisdictions impose tax on software solutions hosted remotely such as software-as-a-service (SaaS) solutions. Others may tax data processing, information services and other technology-related components of telemedicine.

When it comes to sales and use tax implications, telemedicine providers need to take into account who the seller is, who the customer is, how the customer is being charged for the service, and where the customer is receiving the service.

Consider the case of a large medical service provider that owns and maintains the technology infrastructure used to deliver telemedicine services to patients and directly bills them for services. In this simple example, there are two parties to the transaction. The medical service provider is the seller and the patient is the customer. Because the service is being provided remotely through technology, some elements of the service may be deemed taxable.

For example, does the telemedicine provider license an application to the patient to provide services? What components of the service may fall within broad definitions of taxable services in certain taxing jurisdictions? How is the customer charged for the services? Is there a separate charge for the taxable component, such as a software access license? If there is no separate charge for the taxable component, how will a taxing jurisdiction treat bundled transactions from a sales and use tax perspective? Does that state deem the taxable component of the charge to be more than incidental?

Identifying the true object

These and many other questions need to be considered from an indirect tax perspective. Many states will look at the true object of a transaction, which in the case of telemedicine, would likely be the medical service provided to the patient. However, a state could take the position that the taxable component of the service is more than incidental to the overall cost of the service, which could impact the taxability of the overall service. In such a scenario, there may be an opportunity to address issues presented by a bundled charge by either separately stating taxable components on the invoices or separately addressing them within the contracts.

It's extremely important to ensure that contracts, invoices, and other documents clearly articulate the services being provided because they will be used by the taxing jurisdiction to determine the parameters of the transaction.

Another situation for consideration is that of a telemedicine provider that owns the technology platform and contracts with a corporation or health plan to grant telemedicine access to employees and plan members. Here the telemedicine provider acts as a connection point between

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the corporation or health plan, its employees or health plan members, and the medical professionals. The telemedicine provider is the seller, the corporation or health plan is the customer from a contract perspective, and the employee or plan member receives the medical service.

For purposes of determining the tax consequences of the transaction, a taxing jurisdiction will likely look for documentation to define the service that the corporation is purchasing from the telemedicine provider. Language within the contract becomes important. The telemedicine provider wants to ensure the contract describes the services truly being delivered.

Direct or Indirect?

In the state and local tax context, we often hear the phrases "indirect tax" or "direct tax." What do these phrases mean? The answer lies in who receives the payment. If a person or entity is paying a tax to a governmental agency, then it is referred to as a direct tax. By contrast, an indirect tax is one that can be shifted to (or passed on to) another person or entity by the person or business that owes it. An example of a direct tax is a state's income tax, which is paid directly to the state taxing authority. An example of an indirect tax, on the other hand, is sales tax, which is often paid by a consumer but remitted to the state taxing authority by the business that collects it from the consumer.

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Additional tax topics

Finally, there are some other tax issues raised by the use of telemedicine, including tax issues with health plan accounts, R&D tax credits and international tax implications.

Health savings accounts

In March, the IRS issued Notice 2020-15, allowing the testing and treatment of COVID-19 to be considered preventative care and covered by the health plan without having to meet the deductible. This was welcome news for those who have a health plan with a high deductible, which can only be met through preventative care coverage. However, the plan member or the employer can make contributions to a health savings account to reap associated tax benefits.

The CARES Act further broadened the IRS notice by including a temporary exception for telehealth, allowing all telehealth services to be paid by a high deductible health plan without regard to the deductible, and without interrupting the ability to make contributions to health savings accounts. Notably, this exception doesn't have to be related to the treatment or diagnosis of COVID-19. Any telehealth encounter falls under this temporary exception, which has been made available for plan years that begin before January 1, 2022.

R&D tax credits

Some telemedicine-related expenses, including the development of software, can qualify for the research and development (R&D) tax credit. For example, implementing and customizing electronic health record systems and other telemedicine services may qualify for this credit when relevant criteria is met.

Another potential option currently under section 174 includes taking an immediate deduction for some R&D expenses that might otherwise require capitalization or amortization. However, the provision will be amended based on changes required in the Tax Cuts and Jobs Act (TCJA) beginning in 2022. The amendment will eliminate the immediate deduction and require amortization instead. Until then, the immediate deduction is still an opportunity for qualifying expenses.

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International tax consequences

Telemedicine arrangements may go far beyond state lines to cross international borders, initiating some cross-border tax implications. Suppose that a U.S. hospital provides tele-radiology services and works with international companies. It takes films and conducts diagnostic studies in the U.S., then transmits them electronically to a team of radiologists in India, who review the image studies and write reports to send back to the U.S. hospital staff.

In such an arrangement, tax considerations focus on which country is the source of the income, where the taxing jurisdiction is, and whether there is an applicable tax treaty that will eliminate the risk of double taxation.

However, international tax rules are very complex and this is just one example of many potential issues that might come up in this type of situation. Essentially, any arrangement that crosses international borders should be reviewed carefully by a tax advisor to ensure the most beneficial path forward.

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Move from complexity to clarity

As virtual healthcare continues to accelerate, providers of telemedicine and telehealth services will find it beneficial to work with their tax advisors to navigate a complex and ever-evolving tax landscape. They can help ensure that telemedicine providers are making the best use of the tax benefits for expenditures relative to telemedicine and associated technology investments.

While waiting for updated guidance from the IRS and state governments on various aspects of telemedicine, including advanced technology-based services and delivery models, tax advisors can provide the deep knowledge, technical experience and industry insights needed to interpret existing guidance in a telemedicine context.

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Hypothetical scenarios

The following examples highlight various tax implications relative to telemedicine. These are illustrative for tax purposes only. There are no representations about regulatory compliance issues, any reimbursement malpractice, or other non-tax consideration in these examples.

Providing greater access to specialized services

Hypothetical scenario:
University Medical Center, a tax-exempt hospital with the leading neurology department in the state, runs a telestroke program. Certain medication can be beneficial if given within hours of a stroke. For stroke victims in rural areas, however, this timeframe presents many challenges. Under UMC's telestroke program, specialized stroke physicians provide 24/7 coverage for acute stroke evaluations of patients at participating rural hospitals throughout the state. The UMC doctor reviews the patient's medical history and brain images through a shared portal, conducts a remote examination with the patient via video conference, and provides real-time diagnosis and care recommendations to the on-site physician.

Variation

Is the telemedicine service provided subject to the Unrelated Business Income Tax (UBIT)?

Tax insights in action

— There are no authorities directly stating that interaction via video conference is sufficient to establish a patient relationship between the stroke victims and UMC. However, given the direct (albeit remote) and substantial interaction between the UMC doctor and the stroke victims, it seems reasonable to conclude that a patient-doctor relationship is established. Therefore, it seems reasonable to conclude that this service would not be subject to UBIT.

— If, by contrast, there is no direct interaction between UMC and the stroke victims, and it is purely a consultative matter between the UMC doctor and the patient's onsite physician, it is significantly less certain that a doctor-patient relationship has been established between UMC and the victims.

— However, UMC may still be able to demonstrate that the consulting arrangement is substantially related to its healthcare mission (and therefore not subject to UBIT) because the absence of the arrangement would hinder or jeopardize the medical care of the stroke patients of rural hospitals that lack the necessary diagnostic capabilities.

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Working from home due to COVID-19

Hypothetical scenario
Springfield Clinic is a mental health practice employing multiple psychiatrists, psychologists, and nurse practitioners. The clinic's physical offices and all of its patients reside in state A.
As a result of COVID-19, Springfield Clinic suspends in-person appointments and offers existing patients telemedicine sessions, which the medical clinicians can conduct from their homes.
Nurse practitioner Judy conducts these telemedicine appointments remotely from her vacation home in state B.

Variation

State income tax questions: Where is Springfield Clinic taxable? Where is nurse practitioner Judy located? Will Springfield have to withhold on her wages? If so, what state does that withholding need to be in?

Variation A: Springfield Clinic provides a flat-rate stipend to its clinicians for home office equipment and internet service fees. Clinicians are not required to provide receipts, and are allowed to keep any equipment purchased.

Variation B: The Clinic does not offer any reimbursement for technology equipment and telephone/internet service. May a clinician deduct these expenses from her taxable income?

Tax insights in action

— Springfield is located in state A, but Nurse Judy is working from home in State B due to the COVID-19 emergency. That's an important distinction because normally an employee working in a different state creates nexus with the state.

— Since COVID-19 is the reason for why the employee is working from home in state B, numerous states like Pennsylvania and New Jersey are not reevaluating nexus or how income gets sourced in these emergency-related situations. So, in these states, there would be no reevaluation of state withholding taxes related to Nurse Judy's payroll. No nexus or reevaluation on how income gets sourced. It would still get sourced to state A.

— A flat rate stipend for these reasons fits within the Section 139 provision specifically for national emergency situations being the reason for the expenses. The employer can provide the stipend for the employees without including it in income, it doesn't require a receipt and they can keep the equipment.

— Additionally, there are a few best practice suggestions, which are not required under section 139, but can demonstrate it was a 139 expense in a future audit. Have a written memorandum that detailing the amounts, the reason for the stipend and why the amount is reasonable for the incurred expense. If possible, get an attestation from the employees on COVID-19 related expenses.

— The clinic doesn't offer any reimbursement so individuals need to expense it on their own. If these were independent contractors, they could deduct it as a business expense. But since they are employees, they are not able to expense it for reimbursement due to changes made in the Tax Cut and Jobs Act (TCJA).

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Keeping pace with remote patient monitoring

Hypothetical scenario
St. Elsewhere Hospital, a tax-exempt hospital, develops a remote monitoring program for patients that tested positive for COVID-19, but have mild symptoms. Patients in the program are sent home with a thermometer, pulse oximeter and blood pressure monitor. They are instructed to transmit their vitals to St. Elsewhere Hospital at regular intervals using the hospital's proprietary phone app, the "St. Anywhere App." This remote monitoring program is successful and other hospitals express interest. St. Elsewhere decides to license their app to other hospitals.

Variation

In this example of remote patient monitoring (RPM), are any royalty income issues or any other income tax issues raised on a federal level? What are the state and local tax issues?

Tax insights in action

— The licensing of intellectual property will generally generate royalty income. As a general matter, royalty income is excluded from unrelated business taxable income under code provision 512(b)(2).

— If a component of the payment stream is a payment for services, the guidance is clear that this portion is not treated as a royalty. It's necessary to determine if the services are substantially related to the hospital's exempt purposes or not.

— Currently, there is a lack of guidance to suggest that the RPM would itself establish a patient relationship between the hospital and individuals being monitored.

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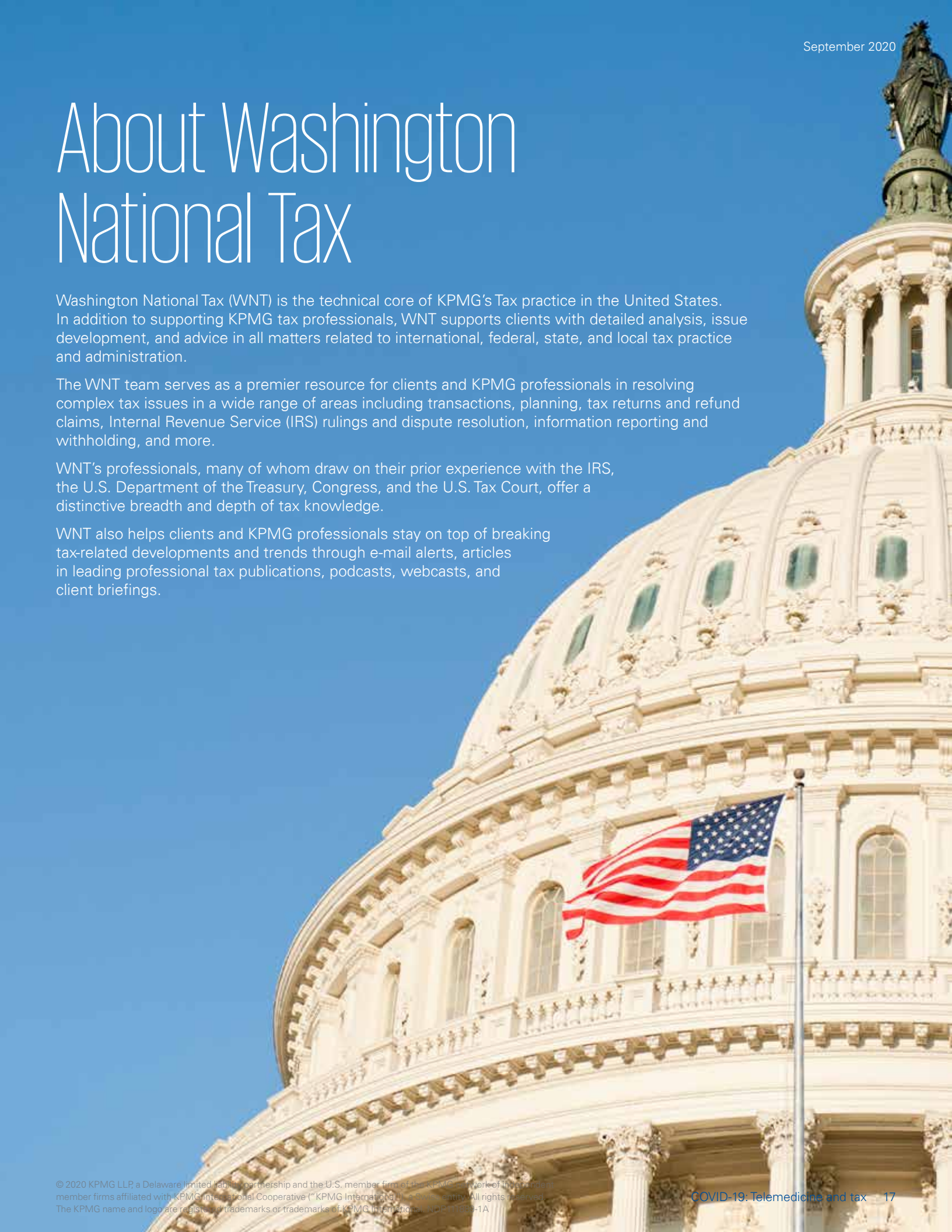
The WNT team serves as a premier resource for clients and KPMG professionals in resolving complex tax issues in a wide range of areas including transactions, planning, tax returns and refund claims, Internal Revenue Service (IRS) rulings and dispute resolution, information reporting and withholding, and more.

WNT's professionals, many of whom draw on their prior experience with the IRS, the U.S. Department of the Treasury, Congress, and the U.S. Tax Court, offer a distinctive breadth and depth of tax knowledge.

WNT also helps clients and KPMG professionals stay on top of breaking tax-related developments and trends through e-mail alerts, articles in leading professional tax publications, podcasts, webcasts, and client briefings.



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