Should We or Should We Not Tax Not-for-Profit Hospitals?

10/17/24

David Burda:

Welcome to the 4sight Health Roundup podcast, 4sight Health's podcast series for healthcare revolutionaries, outcomes matter, customers count and value rules. Hello again, everyone. This is Dave Burda, news editor at 4sight Health. It is Thursday, October 17th. We were off last week, but our thoughts still are with the people, communities, and healthcare providers affected by hurricanes Helene and Milton. We hope you recover soon with the help of the federal government. That's why we pay taxes to support the common good, and that includes our fellow citizens in time of need. Why do you think we pay taxes? A lot of people are asking the same thing about not-for-profit hospitals and health systems. They don't pay taxes in exchange for providing charitable benefits to their communities. Whether that's right or wrong is the topic of today's show with Dave Johnson, founder and CEO 4sight Health, and Julie Murchinson, partner at Transformation Capital. Hi Dave. Hi, Julie. How are you two doing this morning, Dave?

David W. Johnson:

Well, I'm in New York City for the Cain Brothers Annual Healthcare Investors Conference after a couple of down years for PE investing. The mood in the room is very positive for deal flow in 2025. Let's hope they're right.

Burda:

Okay. Well, we'll watch that trend. Thanks, Dave. Julie, how are you?

Julie Murchinson:

I'm in Phoenix where it's hot and sunny. It was 92 yesterday, which is hard to believe. And you know, chugging along. It seems like it's been a busy October.

Burda:

Yeah. You gonna get some tennis in?

Murchinson:

Maybe? We'll see.

Burda:

Okay. You brought your racket though, right? <Laugh>?

Murchinson:

No, no. All work. No play, Dave. Come on.

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Burda:

All right. All right. Now before we talk about hospital tax exemptions, let's talk about these hurricanes. Dave do you know anyone affected by Helene or Milton, and how did they fare?

Johnson:

Well right before Covid hit, I attended a conference of the Health Policy Leadership Council that Amatab Chandra puts together in Asheville, North Carolina. And we happened to have another one of those conferences the week after Helene and the barbecue restaurant where we had our big group dinner gone. The hotel where we stayed in downtown Asheville had eight feet of water in it. The devastation was, is just kind of remarkable. And to see pictures of those sites and the fact it happened in the mountains far away from the seacoast is also remarkable and, and a sign of things to come, unfortunately.

Burda:

Yeah. Yeah. Scary stuff. Thanks, Dave. Julie, you're from Florida. Who do you know that was affected and how did they do?

Murchinson:

Well I know a lot of folks on the West Coast who were really worried this time in ways that they hadn't been before, but my mom is in south Florida and she did not evacuate, and there was more damage in the Palm Beach County area from tornadoes than from the hurricane. And tornadoes are not a typical thing in Florida, so it was weird.

Burda:

Yeah, yeah. Well, I have a number of relatives on my mom's side who live in Florida along the Gulf. Some evacuated, some stayed. They all made it through. And my, my best story is I do know someone who works in healthcare at a prison in Florida, and the prison staff had to stay at the prison overnight during Milton. So that's a double scary, you know, if the hurricane doesn't get you, the shiv will, but they <laugh>, but they all made it through. Right. And it turned into a great story, so there you go. Okay. Let's give some thought to tax exemptions for not-for-profit hospitals and health systems. Thanks to two new reports. The first report is a study in JAMA that estimated the value of hospital's annual tax exemptions at $37.4 billion in 2021. 76% of that came from avoiding federal income tax sales taxes, and local property taxes. The amount varied significantly by state from a low of about $25,000 per hospital bed in Delaware to a high of about $160,000 in Massachusetts. The second report is from Ernst and Young, commissioned by the American Hospital Association, Ernst and Young is now EY for all your cool kids. I'm still wondering what happened to Tush Ross. Anyway, the EY report said not-for-profit hospitals provided a whopping $129 billion in community benefits in 2020 or nearly 10 times. The $13.2 billion they avoided in federal income taxes that year. Of that $129 billion, 44.5% came from unreimbursed costs from Medicaid and other means tested government programs. 28.4% came from community health improvement services like education, research and donations, and 27.1% came from Medicare

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payment shortfalls in bad debt. Dave, first, that $37.4 billion in the JAMA study sounds awfully familiar. <Laugh>, like a number, like a number you came up with. Tell me about that. And then give me one good reason why we should tax or not tax, not-for-profit hospitals.

Johnson:

Well, tax exemption for hospitals has been a burr under my saddle for for quite a while, as you know, Dave.

Murchinson:

<Affirmative>

Johnson:

In 2020 the Harvard Economist I just mentioned, Amatab Chandra and I did some research and, wrote an article on what the real cost of tax exemption was for hospitals, for tax exempt hospitals, and foregone tax revenues. And the number you're, we came up with was 40 billion. So it was slightly higher than the JAMA study. I think the reason we're a little higher than they are. Our base number was 35 billion, and then we added another 5 billion for foregone tax revenues related to non-operating income from investments capital gains and assets sales. That's pretty hard to track. And my guess is there's some of that that the JAMA study missed that would push the number probably above 40 billion right now. Anyway, you slice it, it's a big number. I happen to know one of the JAMA studies authors, Guy Bihe; Julie, I don't know if you know her or not, but from Johns Hopkins. And she's an accountant by background and a real stickler for detail. And you might remember a couple of years ago one of her colleagues at Hopkins, Gerald Anderson published this study that said the cost of tax exemption was $60 billion. So a full 50% more than where Guy is coming out. And I remember talking to her about it, and she took exception to how he was interpreting many of the numbers. So I had enormous respect for her then, and, you know, equally an equal amount today. Your second question, Dave, is one good reason for either, you know, taxing or not taxing hospitals. And, you know, I come down in favor of taxing. So any economist will tell you if you want less of something, you should tax it. It's not that complicated, right? When you tax something people buy less of it or provide less of it. vWe have an overbuilt acute care infrastructure system. If we want less of that, we should tax it. And the great thing about that is we could apply some of these foregone lost revenues, the 40 ish billion dollars, which is a huge number. It's almost the equivalent of what new hospital construction costs each year. We could use those proceeds in part, at least to fund transformation. So more health so we need less healthcare. So that's that's where I would go with my one. Good reason. We want less, less healthcare, fewer hospitals, more investment in health. Let's use the tax policies of countries to support that goal, not what we're doing today, which is needlessly supporting expansion of the current acute care footprint in the country.

Burda:

Yeah, sounds like a good idea. But higher taxes haven't stopped people from smoking, right? <Laugh>?

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Johnson:
Oh, yeah. They have <laugh>. You know, how much a pack of cigarettes cost these days?

Burda:
I have, I have no idea.

Johnson:
It's over, it's over 10 bucks and it's like 95% taxes,

Burda:
<Laugh>. Oh, that's great. That's a good analogy. Julie, any questions for Dave?

Murchinson:
Yeah, Dave you know, in a policy brief from the Lown Institute, they suggested remedies including establishing minimum thresholds for US hospital community benefit spending, requiring more detailed tax reporting and adopting intermediate enforcement actions like financial penalties for noncompliance. Do you have thoughts on these?

Johnson:
Well, I love the Lown Institute, and for over a decade, they've been a remarkably strong voice. I think they're headquartered in Boston, but a remarkably strong voice for social responsibility and high value care. So I think anything that they produce is, is worth paying attention to. These particular solutions, I think aren't bad. They're regulatory in nature. They're incremental. They would move the ball forward. But as I was just talking about, I think we need an exponential solution, which would be, you know, taxing all providers and redirecting monies toward the loan policies, goals of better access, social responsibility, high value care eliminating unnecessary care and so on. And one thing I didn't mention in my previous answer sort of supports this idea of being more dramatic. And Dave, you had this in your synopsis, at least some of it, is that the benefits of tax exemption are massive and unevenly distributed. So 7% of the hospitals account for half of that cost of tax exemption. And the top 1%, which is 29 hospitals accounted for 19%. So what we're, when we're talking about kind of doing away with this, we're really going at the bigger, more established names and they're the ones who, that are in the best position to afford it. Obviously, the, the burden would fall disproportionately on hospitals and low income communities. And we should have programs in place if we do move in the direction I'm talking about to redirect funding into these communities with the goal of improving health broadly, not just increasing access, although increasing access is obviously very important too.

Burda:

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Yeah. It's how you use the tax revenue. Thanks, Dave. Julie, Dave mentioned the AJ report at the end of our October 3rd show. And correct me if I'm wrong, but I thought I heard you say the word cheating. <Laugh>, what's your take on the a HA report and then give me one good reason why we should tax or not tax not-for-profit hospitals?

Murchinson:

That wasn't nice of me, was it?

Burda:

You know, but it was accurate.

Murchinson:

Yeah, true.

Johnson:

He's, he's got the recording, Julie. That's right. You know, he can nail this at any time.

Burda:

I didn't edit it out. <Laugh>,

Murchinson:

<Laugh> I have to be more careful. You know, this is a tough issue despite how black and white every report makes it look, or even sometimes how we talk about it here, right? And I don't know if you saw this state, but one of the Northwestern policy researchers said something that is so true. It's how you do the math and what you're counting. Like no, duh. So the AJ hires EY, by the way, Deloitte two is, I'm sorry, <inaudible> Dave.

Burda:

Oh, Okay, okay. Yeah.

Murchinson:

But the AJ hires EY who's using an accounting, you know, more that's more favorable to hospitals versus JAMA or alone, or, you know, all these other calculations. You, you literally can't win. So, you know, I look at this like hospitals run on what one to 2% hospital margins. And honestly, given the choice, I would not willingly get involved in a business like this. Like it doesn't, it's not an attractive business. So, you know the issue I guess for me is the way this, the taxation issue impacts others is what really kind of brows me up. So I chose to look at how the IRS tax breaks impacts on the headline issues that we talk

about and other organizations outside of healthcare. And it's unfair all around, you know, the IRS will not provide similar tax breaks to direct primary care or other innovative care models that promote prevention, and they absolutely will not do this. Now, many of those organizations are for-profit, but I'd have to imagine that if they actually provided tax breaks, you'd see more preventative health or and healthcare organizations grow up in the nonprofit space. It's simply not happening. So that's number one. Number two, the IRS warned Americans that they cannot use HSA funds to buy healthy foods as direct to better doctors, despite the linkage between healthy food and health and the continued challenges we have with access to healthy food and food, others. And when you look these last two examples with primary, primary care and healthy food, this is coming at a time when, you know, chronic diseases are leading the leading cause of death in the us and by the way, super expensive too. And it's as if the IRS is supporting sick care rather than health. That's absolutely what they're doing. So second thing I also look at is when I look at the business model, it's easy to see salaries of many, but not all hospital execs. As extraordinarily high. And according to public tax records, in 2022, Cedar-Sinai had an income surplus of seven 50 million. And Sloan Memorial Sloan Kettering of 400 million, neither paid federal taxes, the top three hospital administrators made nearly $20 million in salaries of these organizations. So the, you know, is the IRS effectively contributing to outsize earnings by some of these executives and frankly, supporting like major wage gaps perhaps. And last I'll turn to what I think is actually most deplorable; the impact to organizations like our public schools. In 2023, a Pennsylvania judge revoked a hospital's property tax exemption after the past town school district sued the hospital arguing that its special tax treatment resulted in $900,000 less revenue for the school each year. This is because of avoidance of property tax. So this is when I really start to question the tax treatment, like when we're stealing from education to pay healthcare, what are we doing? So, you know, I'd like to see the tax treatment redefined to support health and not steal from other important organizations like education and maybe come with strings related to actually driving down costs. And I know that that is out of, you know, IRS hands to do things like that last bit. But it's pretty clear to me that hospitals are getting a pretty good deal.

Burda:

Yeah. What do they call it? Payment in lieu of taxes, I think when they make those settlements in Pennsylvania and elsewhere. Thanks, Julie. Great. great analysis, especially the IRS stuff. I did not know any of that. Dave, any questions for Julie?

Johnson:

Yeah, any way you look at it, it's pretty ugly. Among my favorite aphorisms, Julie, is hypocrisy is the tribute vice pays to virtue. I actually have that hanging on a little needlework sampler from the 18 hundreds in my office. So given that relationship between Vice and Virtue do you know anyone, I mean, anyone that's persuaded by the AHA’s report I guess which is the NY report funded by the AHA, that the community benefit provided by tax hospitals is multiples higher than the ORONE tax revenues that sub society provides these organizations as you were just describing, to support their operations. And if not, and I'd be surprised if you do, but if not, and I don't mean to be overly cynical, why does the AHA bother to engage in this annual ritual and in, in misinformation and in the process invite accusations of hypocrisy? Is there any lost virtue amid, amid these mountains of vice?

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Murchinson::

Well, first, Dave, you had me at needlepoint <laugh>. That's cute. <Laugh>.

Burda:

Yeah. We'll do a show on what we have hanging on our walls. That would be an interesting show. <Laugh>.

Murchinson:

Well, Dave, I mean, you hit the nail on the head, but this is the age of disinformation, right? I mean, we swim in it, we love it. It's disgusting, <laugh>. So, I mean, the AJ undoubtedly looks at this as third party validation that they and their members, and most importantly, their army of lobbyists can use to just continue marching on. And, you know, this is just the way it works. And as a former CPA auditing hospitals is the first thing I ever did in my career. And studying like crazy cost accounting and all the things that hospitals just don't do well there will never be a right answer. So it pays for a HA to continue to surf the gray waters.

Burda:

Yeah, they have to get their voices heard. So I, I hear you. Thanks, Julie. Now, as, as a cub reporter, I covered this tax exemption issue pretty extensively. Someday I'll tell you about the story I wrote about HCA under Rick Scott claiming that paying taxes is equal to providing charity care. And for that story, I interviewed owners of a strip club, a gun club, and a liquor store for the story <laugh>. My God. And since we are recording, and for the record, I did those interviews over the phone, so there you go.

Johnson:

Impressive.

Burda:

When you guys get a little, a little older, I'll, I'll share it with you. <Laugh> <laugh>. Anyways, let's talk about other big healthcare news that happened this past week. Wasn't all bad, was it, Julie? What else happened that we should know about?

Murchinson:

Well, I noticed another article about Ascension unloading some hospitals and some other potentially underperforming services to Prime Health. At least nine hospitals they sold to Prime Health. So, you know, Ascension, Tenant and maybe others are, you know, continuing to quietly unload poor performing assets.

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Burda:

Yeah, it's like a game of hospital monopoly out there right now.

Murchinson:

Yeah.

Burda:

Dave, what other news is worth mentioning?

Johnson:

As I mentioned, I'm at the healthcare Investors conference at Cain Brothers, and one of the mainstays every year is a really good private equity panel. And yesterday's panel was no exception. But it's interesting kinda listening to how that dialogue unfolds. And it's a lot of very deep assessment of the relative leverage that sectors have, the various healthcare sectors have over one another. You know, for example, providers getting the better of payers in this, this ma debate that's unfolding the inability of specialty pharma to really deal with the, with PBMs. And meanwhile, yet all around the conference are dozens of companies making strategic long-term bets on value consumerism, improving health outcomes, all the things we talk about all the time. And it's it's a little bit of a jarring contrast. And when asked about it Anna Hokuey from Valtrius, who's fantastic, just made the comment that she thinks we're close to the tipping point. But she said, I've been saying that for five to seven years, <laugh>. So you know, atwhat point do we get enough of this activity and enough scale that it really fundamentally begins to change supply demand dynamics. So we, we don't have to debate the relative positioning of payers versus providers anymore. We can start talking about how do we deliver better outcomes at lower cost with better customer experience and better overall population health. Halleilujiah to that.

Burda:

Alright? Yeah. What's good for customers is good for business, right? So sounds like we're finally headed in the right direction. Thanks Dave, and thanks, Julie. That is all the time we have for today. If you'd like to learn more about the topics we discussed on today's show, please visit our website at 4sighthealth.com. You can also subscribe to the roundup on Spotify, Apple Podcasts, YouTube, or wherever you listen to your favorites. Don't miss another segment of the best 20 minutes in healthcare. Thanks for listening, I'm Dave Burda for 4sight Health.