



COMMENTS OF VHA INC. ON TAX REFORM: MAINTAINING CURRENT TAX TREATMENT OF TAX-EXEMPT FINANCING FOR CHARITABLE HOSPITALS

Submitted to the Charitable/Exempt Organizations Tax Reform Working Group and the Debt, Equity and Capital Tax Reform Working Group of the Committee on Ways and Means on April 8, 2013

VHA Inc. appreciates the opportunity to provide comments on certain concerns and policy priorities of nonprofit hospitals regarding federal tax reform. The principal focus of this submission is to highlight the importance of maintaining the current exclusion from income under the Internal Revenue Code for interest on bonds used to finance facilities of charitable tax-exempt hospitals, including the modernization of existing facilities to more effectively deliver health care to patients.

Founded in 1977, VHA is dedicated to the success of nonprofit, community-based health care. VHA is a national alliance of over 1,400 nonprofit hospitals and more than 23,000 non-acute health care organizations. VHA helps its members deliver safe, effective and cost-efficient health care through both national and local support. VHA has 15 regional offices covering 47 states, as well as a public policy office in Washington, D.C.

For many years, VHA has undertaken a leadership role in the field of community benefit for nonprofit hospitals. VHA supports its members in their task of assessing and meeting community health needs by providing tools, best practices and other resources.

What Matters to Tax-exempt Hospitals in the Context of Federal Tax Reform

VHA supports efforts to make the tax code fairer, simpler and more efficient. We agree with the many members of this Committee who have recognized that the economy loses substantial amounts of productivity each year because of our burdensome tax system.

Nonprofit health care organizations play a critical role in community health needs, and more is being asked of them every day because of the growth in our uninsured (or underinsured) populations. Federal tax benefits are important in helping such organizations carry out their missions and meet their needs for capital.

As the Ways & Means Committee continues its work on tax reform legislation, it should avoid taking any action that would jeopardize the following core provisions:

- income tax exemption for charitable hospitals
- tax-exempt financing for hospital facilities
- deductibility of charitable contributions and bequests for hospital donors

All three of these tax provisions help nonprofit hospitals provide a full array of community benefit, including charity care and other financial assistance on behalf of uninsured and low-income

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persons, subsidized health services, community health improvement services, community building activities, as well as clinical research and medical education.

Current Law Governing Tax-Exempt Bonds for 501(c)(3) Hospitals

A key tax provision under current law is the exclusion for tax-exempt bond interest under Section 103 of the Code. The exclusion results in the issuance of governmental bonds at lower interest rates than would otherwise apply if the investor had to pay tax on the interest.

Section 141 provides similar tax treatment for certain "qualified" private activity bonds, which include bonds issued by state or local governments to finance facilities and certain working capital needs of charitable organizations described in Section 501(c)(3). Tax-exempt hospitals use these "qualified 501(c)(3) bonds" to finance the expansion and renovation of hospital and clinical facilities.

Why Tax-Exempt Financing is Needed

Charitable hospitals have long relied on tax-exempt financing to obtain much needed capital. Since nonprofit hospitals by law cannot raise money by issuing stock to investors, debt and retained earnings are their only sources of capital to make the investments in staff, facilities and technology that are required to deliver the safe, high-quality care their communities need and deserve. While the markets for tax-exempt financing by hospitals are fairly well established at present, charitable hospitals and other nonprofit organizations would be severely hampered in obtaining debt financing at all if these markets were disrupted through significant changes to the tax treatment of interest paid on tax-exempt bonds. For hospitals struggling to cope with reduced Medicare and Medicaid payments, as well as other forces that have reduced hospital margins, the potential removal or reduction of tax advantages associated with tax-exempt financing, particularly 501(c)(3) bonds, could not come at a worse time. Even if more hospital beds are not needed in a particular community, almost all nonprofit hospitals face the need to modernize their facilities and to equip them with new technology (such as equipment to facilitate telemedicine and the use of electronic medical records).

Current Law Generally Works Well, But it Could be Streamlined and Simplified

It is important to recognize that 501(c)(3) bonds and the charitable organizations that use them are heavily regulated under federal and state law. While 501(c)(3) bonds are not subject to state volume caps on private activity bonds, the Internal Revenue Code imposes strict arbitrage rules, advanced refunding limitations, cost of issuance and other requirements. Furthermore, as borrowers, 501(c)(3) organizations are required to provide a significant amount of information informing bondholders and the public about their operations, including their use of bond proceeds. Finally, all 501(c)(3) organizations are subject to strict rules against private inurement and private benefit. In addition, 501(c)(3) hospitals and health systems are now subject to new additional requirements (enacted as part of Affordable Care Act) designed to further ensure that nonprofit hospitals remain focused on their mission of meeting community health needs.

Unfortunately, many of the rules applicable to tax-exempt bonds are extremely complex and the transactional costs associated with compliance frequently erode the anticipated savings in interest costs. Transactional costs are especially detrimental to small community and rural hospitals that face significant difficulties in obtaining financing at reasonable rates. VHA recommends that

Congress focus on reforms that would simplify the tax-exempt bond rules, thereby making such financing accessible to small community and mid-sized regional hospitals as well as to larger health systems.

Proposals to Cap Tax-Exempt Interest Are Also Detrimental

The Obama Administration's fiscal year 2013 budget contained a proposal to cap the exclusion from income for state and local bond interest at an amount equal to the tax benefit accorded to someone taxed at a 28 percent marginal rate. The proposal would apply to both new and existing state and local bonds. VHA anticipates that the Obama Administration's budget for fiscal year 2014 (expected to be released on April 10) will also contain the retroactive 28 percent cap on the exclusion for state and local bond interest. With the top income tax bracket currently at 39.6 percent, limiting the deduction for state and local bond interest to 28 percent would result in an 11.6 percent tax on individual bond investors in that upper bracket. It would also unsettle the bond market, thereby driving up interest rates for governmental and charitable borrowers.

Conclusion

Nonprofit hospitals and health systems provide essential services efficiently and compassionately every day in communities throughout the United States. Their work in further of their charitable missions contributes significantly to the public good and lessens the burdens of government. In view of anticipated cuts in Medicare funding under the Affordable Care Act, nonprofit community hospitals and health care organizations will be challenged to do more than ever before to maintain access to quality health care for all Americans. The exclusion for tax-exempt bonds is critical to the ability of tax-exempt hospitals to raise funds for major capital projects at a reasonable cost.

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