

CASE 11.2**Tax Exemption for Not-for-Profit Hospitals**

"Tax exemption for not-for-profit hospitals is a historical relic," said Tyler at a hospital board meeting. "When income tax started in 1894, there was no Medicare, no Medicaid, and no insurance. People with money got care at home. The role of hospitals was to care for the poor. These days, hospitals are profitable businesses that serve paying customers. Even lobbyists for the industry concede that that exemption from federal, state, and local taxes almost certainly costs more than the care not-for-profit hospitals provide for free to the poor. For-profits, which pay income and property taxes, provide about as much uncompensated care as not-for-profits. Plus, a lot of free care is mandatory. Federal and state laws require all hospitals to provide emergency care without regard for ability to pay.

"Look, well-run 'not-for-profit' hospitals make plenty of money, and their managers get paid very well. I have no problem with that, but they shouldn't get a tax break, too." With that, Tyler sat down.

Corey then approached the microphone, saying, "I know that we provide charity care. But Suburban Clinic, which is for-profit and pays local property taxes, does too. And it provides only a little less than we do. A first guess at our property value would be \$60 million. The local taxes on that would be about \$1.8 million. Even using the inflated estimates that we float, which are based on list prices, there's no way that its community benefit approaches that amount of money. Have you seen the roads in this town? We could really use the tax revenue. And I wouldn't mind a tax cut. My taxes help pay for our nonpayment of taxes. You know, we bought three for-profit physician practices, and I see no difference in the way they are run. I think this is just a scam to avoid paying taxes."

After Corey sat down, Lee, the hospital's CEO, took the floor. "We provide a broad array of benefits to this community. We provide charity care, our prices are lower than our competitors, we operate a nursing school, we operate asthma and heart failure programs that consistently lose money, and we operate a number of community outreach programs. I think this community is well served by its recognition of our charitable mission. Yes, we are profitable, but we need to stay in business. I look forward to working with the board of assessors to

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clear up any questions about the merits of our not-for-profit status. I am confident that they are based on a misunderstanding of the situation.”

Several more speakers came to the microphone, but none brought a lot of new information. Next, the board of assessors had to make a decision about the status of the hospital.

Discussion questions:

- What evidence about the level of community benefit provided by not-for-profit and for-profit hospitals is available?
- Why does using list prices tend to inflate estimates of community benefit?
- Are there other important differences between not-for-profit and for-profit hospitals?
- Would the city be better off if it taxed the hospital and paid for charity care?
- More broadly, is tax exemption a good way to encourage private organizations to serve the public interest?
- What should the board of assessors do? What are its options?

Exercises

- 11.1 A clinic has \$1 million in revenues and \$950,000 in costs. What is its operating margin?
- 11.2 The owners of the clinic in Exercise 11.1 invested \$400,000. What is the return on investment? Is it adequate?
- 11.3 A laboratory has \$4.2 million in revenues and \$3.85 million in costs. What is its operating margin?
- 11.4 The owners of the laboratory in Exercise 11.3 invested \$6 million. What is the return on investment?
- 11.5 Go to the website of the Board of Governors of the Federal Reserve System (www.federalreserve.gov). What is the current annual yield for one-year Treasury securities?
- 11.6 Go to the Yahoo! Finance website (<http://finance.yahoo.com>) and look up the operating margin and return on equity for Community Health Systems (symbol CYH). How does this company compare to Aetna (AET), Amgen (AMGN), Laboratory Corporation of America (LH), and Tenet Healthcare Corporation (THC)?