JOINT LEGISLATIVE AUDIT AND REVIEW COMMISSION
Fiscal Impact Review
2014 Special Session

Bill Number: SB 5008
Review Requested By: Senator Walter Stosch and Senator Charles Colgan, Sr.

JLARC Staff Fiscal Estimates

JLARC staff estimate that SB 5008 could reduce income tax revenue by approximately $450,000 annually for three years. Reductions to general fund revenue would likely occur in FY 2016 and FY 2017. The largest reduction is expected to occur in FY 2016 as a result of hospitals submitting amended tax returns for the first two years of the credit.

SB 5008 would create an income tax credit for tax years 2014-2016 for proprietary (for-profit) hospitals in Virginia that provide free or low-cost medical services. The amount of credits awarded would be determined based on the eligible expenses that hospitals incur to provide free or low-cost services. The credits awarded could not exceed the reduction in Medicare reimbursement rates at individual hospitals and across hospitals statewide resulting from changes under the federal Patient Protection and Affordable Care Act (ACA). The credits awarded also could not exceed the state income tax liability of proprietary hospitals because credits could not be refunded, transferred, or carried forward. Not-for-profit hospitals would not be eligible for tax credits under SB 5008 because they are exempt from income taxes.

The fiscal impact of SB 5008 could be higher or lower than the JLARC staff estimate depending on the number of proprietary hospitals and their level of eligible expenses, Medicare reimbursement reductions, and income tax liability in future years.

An explanation of the JLARC staff review is included on the following pages.

Authorized for Release:

Hal E Greer

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Director

Bill Summary: Senate Bill (SB) 5008 would create an income tax credit for proprietary (for-profit) hospitals in the state that provide free or low-cost medical services. The credit amount would be determined based on the eligible expenses incurred by each hospital to provide free or low-cost services. The credit could not exceed the reduction in Medicare reimbursements resulting from the implementation of the federal Patient Protection and Affordable Care Act (ACA) at each hospital. In addition, the total amount of tax credits issued by the state in a given year could not exceed the total reduction in Medicare reimbursements across proprietary hospitals statewide. The credit would be available for tax years 2014, 2015, and 2016 and could not be refunded, transferred, or carried forward.

Discussion of Fiscal Implications: SB 5008 would address reductions in Medicare reimbursements experienced by proprietary hospitals as a result of provisions in the ACA. Because the tax credit could not be refunded, transferred, or carried forward, hospitals would receive credits up to the lesser of their eligible expenses, reduction in Medicare reimbursements, or state income tax liability. The tax credit would not apply to not-for-profit hospitals, which comprise approximately 70 percent of hospitals in the state, because they are exempt from income taxes.

The fiscal impact of the proposed tax credit depends on several factors: (i) the total eligible expenses incurred by proprietary hospitals to provide free or low-cost medical services, (ii) the reduction in Medicare reimbursements to proprietary hospitals individually and statewide after implementation of the ACA, and (iii) the income tax liability of proprietary hospitals in the state.

<u>Factor 1: Eligible Expenses Related to Free or Low-Cost Medical Services</u>

The proposed bill indicates that proprietary hospitals would receive a tax credit for "eligible expenses," which are defined as "expenses incurred for the provision of low-cost or no-cost medical services." There is no standard definition for "low-cost or no-cost medical services," but stakeholders indicate that several types of expenses could be included, such as charity care expenses, bad debt expenses, and Medicaid expenses that hospitals do not recoup (Medicaid shortfall).

Virginia Health Information (VHI) collects data related to charity care, bad debt, and Medicaid revenue each year. The most recent data available is for FY 2013. The VHI data represents the amount that hospitals charge for services rather than the cost they incur to provide services, which can be significantly lower than patient charges. Consequently, JLARC staff applied a ratio of hospital costs to patient charges to approximate proprietary hospitals' expenses. This ratio is used by the American Hospital Association to calculate uncompensated care charges.

Statewide, proprietary hospitals are estimated to have incurred approximately $44.9 million in expenses related to charity care in FY 2013. Charity care is care for which no payment is required from individuals whose gross annual family income is below a certain threshold. Depending on the hospital's charity care policies, select individuals can also qualify for partial charity care.

Proprietary hospitals in Virginia are estimated to have incurred approximately $65.9 million in bad debt expenses in FY 2013. Bad debt expenses occur when individuals do not pay for the medical services they receive but they were not approved for charity care. The population of individuals who incur bad debt includes individuals with and without health insurance.

Medicaid shortfalls were estimated to cost proprietary hospitals in Virginia approximately $70.8 million in FY 2013. A Medicaid shortfall occurs when payments do not fully reimburse hospitals for the expenses they incur to treat Medicaid recipients.

Combined, eligible expenses for charity care, bad debt, and Medicaid shortfalls are estimated to total $181.5 million across 29 proprietary hospitals in Virginia in FY 2013. (Cumberland Hospital for Children and

Adolescents was excluded because it does not provide services for Medicare patients and therefore would not be eligible for the proposed tax credit.) At individual hospitals, eligible expenses ranged from $231,428 to $29.8 million. Estimates of "eligible expenses" could change depending on whether the definition is interpreted to be more or less inclusive of medical costs. Also, differing hospital cost to patient charge ratios would affect eligible expense estimates.

Factor 2: Medicare Reimbursement Reductions

The ACA required several reductions in Medicare reimbursements, including reductions in annual payment updates for certain types of providers, payment adjustments based on hospital productivity, and reductions in disproportionate share hospital payments. The proposed tax credit is designed to compensate proprietary hospitals for reductions in Medicare reimbursements, not to exceed the level of reductions at individual proprietary hospitals or across proprietary hospitals statewide.

According to the Virginia Hospital & Healthcare Association (VHHA), hospital associations nationwide use analysis completed by the Healthcare Association of New York State (HANYS) to approximate Medicare reimbursement reductions at hospitals as a result of the ACA. (This data comes from multiple sources and is not currently tracked within Virginia.) HANYS's estimates are not precise enough to determine the exact amount of credits for which hospitals would be eligible under SB 5008, but they provide an approximation.

Table 1: Medicare Reimbursement Reductions at Virginia's Proprietary Hospitals

Proprietary Hospital	FY 2014 ACA Impact	FY 2015 ACA Impact	FY 2016 ACA Impact
CJW Medical Center	$(3,880,800)	$(8,380,000)	$(10,044,200)
Henrico Doctors' Hospital	(3,151,900)	(5,582,600)	(6,810,600)
LewisGale Medical Center	(2,451,700)	(3,994,800)	(5,015,200)
Danville Regional Medical Center	(1,963,200)	(4,715,900)	(5,639,100)
Southside Regional Medical Center	(1,786,300)	(4,095,300)	(4,899,000)
Memorial Hospital of Martinsville & Henry County	(1,256,200)	(2,365,000)	(2,872,500)
Reston Hospital Center	(1,192,600)	(1,615,600)	(2,025,900)
Clinch Valley Medical Center	(780,800)	(2,242,700)	(2,670,200)
LewisGale Hospital Montgomery	(659,000)	(1,289,400)	(1,565,500)
John Randolph Medical Center	(571,900)	(1,159,400)	(1,407,600)
Pulaski Community Hospital	(503,800)	(1,063,300)	(1,298,000)
Twin County Regional Hospital	(450,800)	(709,300)	(955,000)
Southern Virginia Regional Medical Center	(428,500)	(1,169,900)	(1,401,000)
Wythe County Community Hospital	(363,500)	(712,500)	(912,300)
Spotsylvania Regional Medical Center	(299,600)	(427,300)	(521,000)
Southampton Memorial Hospital	(289,400)	(520,600)	(667,600)
LewisGale Hospital - Alleghany	(275,700)	(462,900)	(614,100)
HealthSouth Rehabilitation Hospital of Petersburg	(272,000)	(418,500)	(573,500)
HealthSouth Rehabilitation Hospital of Virginia	(230,600)	(354,900)	(486,300)
HealthSouth Rehab Hospital of Fredericksburg	(209,700)	(322,600)	(442,100)
UVA HealthSouth Rehabilitation Hospital	(208,000)	(320,100)	(438,700)
Kindred Hospital Richmond	(172,000)	(263,900)	(361,000)
HealthSouth Rehab Hospital of Northern Virginia	(170,000)	(261,600)	(358,400)
The Rehabilitation Hospital of Southwest Virginia	(101,600)	(156,400)	(214,300)
Virginia Beach Psychiatric Center	(69,700)	(115,800)	(160,200)
Poplar Springs Hospital	(53,600)	(89,300)	(123,600)
Dominion Hospital	(22,300)	(37,100)	(51,300)
Statewide Total	**$(21,815,200)**	**$(42,846,700)**	**$(52,528,200)**

Source: ACA impact estimated by HANYS and provided by VHHA.
Notes: Pioneer Community Hospital of Patrick County, Fauquier Hospital, and Cumberland Hospital for Children and Adolescents were excluded because no ACA impact was calculated by HANYS.

According to HANYS's estimates, the ACA reduced Medicare reimbursements to Virginia proprietary hospitals by nearly $22 million in FY 2014 (Table 1). At individual proprietary hospitals, Medicare reimbursement reductions ranged from approximately $22,000 to $3.9 million. Reductions will increase in future years, totaling nearly $43 million in FY 2015 and $53 million in FY 2016.

Factor 3: State Income Tax Liability of Proprietary Hospitals

The amount of tax credit that a proprietary hospital could collect under SB 5008 may ultimately be limited by the size of its state income tax liability. Hospitals may be eligible for a tax credit that is larger than their income tax liability. However, because the proposed credit cannot be refunded, transferred, or carried forward, proprietary hospitals could not use tax credits that exceed their tax liability.

According to the Department of Taxation (TAX), fewer than 10 of the state's proprietary hospitals had a positive income tax liability in TY 2012 (the most recent year for which tax data was available). Combined, these proprietary hospitals had a total income tax liability of about $450,000 statewide in TY 2012.

Fiscal Impact Estimate: Based on JLARC staff calculations and information from TAX, SB 5008 is estimated to reduce income tax revenue by $450,000 annually for three years (for a total of up to $1.3 million). This aggregate annual amount is determined by the lessor of the estimated eligible expenses, Medicare reimbursement reduction, or the state income tax liability of proprietary hospitals. Proprietary hospitals without a tax liability would be unable to use the proposed tax credit.

Reductions to general fund revenue are expected to occur in FY 2016 and FY 2017, with the largest reduction occurring in FY 2016. This is due to hospitals likely submitting amended tax returns for the first two years of the credit. The tax strategy of individual proprietary hospitals and the availability of Medicare reimbursement reduction data would impact how the revenue reduction is distributed in each year.

The fiscal impact of SB 5008 could vary if the income tax liability of proprietary hospitals fluctuates significantly in future years. Changes to the composition of proprietary hospitals in Virginia could also affect the fiscal impact of SB 5008 if hospitals open, close, or consolidate. Changes to the level of eligible expenses and Medicare reimbursement reductions could additionally affect the fiscal impact of the proposed tax credit, but only if the income tax liability of proprietary hospitals exceeds eligible expenses or Medicare reimbursement reductions.

Not-for-Profit Hospitals: Although they would not be eligible for the proposed tax credit, not-for-profit hospitals are also affected by Medicare reimbursement reductions under the ACA. In FY 2013, there were 71 not-for-profit hospitals in Virginia. According to HANYS, not-for-profit hospitals are estimated to have experienced $106 million in Medicare reimbursement reductions in FY 2014, and they are expected to experience $219 million and $266 million in reductions in FY 2015 and FY 2016, respectively. These reductions are greater than the Medicare reimbursement reductions for proprietary hospitals largely because there are more not-for-profit hospitals in the state.

Budget Amendment Necessary: The proposed tax credit would not require a budget amendment because the credit would result in foregone general fund revenue, not direct government spending. However, the Department of Medical Assistance Services indicates it would need additional resources to collect and monitor data on Medicare reimbursement reductions at proprietary hospitals each year, as required by SB 5008. The Department of Taxation does not anticipate requiring additional resources due to the low volume of proprietary hospitals that would be able to claim the proposed tax credit.

SB 5008 (line 29) indicates that the Tax Commissioner would not issue more credits than the "total annual reduction in Medicare payments to all hospitals in the Commonwealth." For the purpose of this review, JLARC staff assumed that "all hospitals" meant all proprietary hospitals. This language should be clarified.

Agencies Affected: Department of Medical Assistance Services, Department of Taxation.

Date Released, Prepared By: 1/9/2015, Lauren Axselle.