American Hospital Association

NACUBO National Association of College and University Business Officers

NAHEFFA National Association of Health and Educational Facilities Finance Authorities

July 17, 2017

The Honorable Orrin Hatch
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Hatch and Ranking Member Wyden:

In response to your request for stakeholder input on reform of the nation's tax code, we write on behalf of the American Hospital Association (AHA), the National Association of College and University Business Officers (NACUBO), and the National Association of Health and Educational Facilities Finance Authorities (NAHEFFA).

AHA is a national organization founded in 1898 that represents and serves all types of hospitals, health care networks, and their patients and communities. Nearly 5,000 hospitals, health systems and other health care organizations, and their clinical partners – including more than 270,000 affiliated physicians, 2 million nurses and other caregivers – and 43,000 health care leaders come together to form the AHA.

NACUBO is a membership organization representing more than 2,100 colleges and universities across the country. NACUBO specifically represents the chief business and financial officers through advocacy efforts, community service, and professional development activities. The association's mission is to advance the economic viability, business practices, and support for higher education institutions in fulfillment of their missions.

NAHEFFA supports access to readily available, low-cost capital financing options for not-for-profit healthcare and higher education institutions as well as any public or not-for-profit private entity which has a primary goal of providing health care or educational services. NAHEFFA seeks to enhance the effectiveness of these organizations and focuses its efforts on issues which directly influence the availability of, or access to, financing options for health and educational institutions, such as tax-exempt bonds.

Together, our organizations represent thousands of U.S. colleges, universities, and hospitals, as well as the finance authorities dedicated to providing capital financing for not-for-profit healthcare and higher education institutions.

As Congress begins the hard work of reforming the nation's tax code, we respectfully urge that the Senate Finance Committee protect and maintain tax-exempt bond financing, including qualified 501(c)(3) private-activity bonds, which is necessary for the missions and continued financial health of hospitals, colleges, universities, and other charitable organizations and which promotes critical infrastructure and economic development throughout the United States. Further, the liberalization of the IRC section 265 "bank deductibility" rules would allow thousands of small nonprofits and small governments to invest in critical infrastructure in communities all over America by encouraging bank purchases of tax-exempt debt.

Low-cost access to capital helps keep nonprofit health and education institutions strong, enabling them to keep infrastructure expenditures low so that they can efficiently fulfill their missions and focus on the work they do for the public good—making our lives, our economy, and our nation stronger.

One of the many ways the federal government invests in human capital and innovation in the United States is by granting tax-exempt status to hospitals, health clinics, colleges, universities, and other charitable institutions whose health, public service, education, and research missions provide a wide range of societal benefits. Hospitals, colleges, and universities are economic mainstays, providing stability and job growth in communities.

Hospitals employed more than 5.7 million people in 2015 and purchased more than $852 billion in goods and services from other businesses. Each hospital job supports about two additional jobs, and every dollar spent by a hospital supports roughly $2.30 of additional business activity.

There are more than 3,300 public and nonprofit colleges and universities in the U.S., educating nearly 19 million students, engaging in more than $67 billion in research and development, and contributing to a vast array of public service endeavors.

Public universities and hospitals are typically a component of state or local governments, while independent, community-based institutions are recognized as tax-exempt organizations under section *501(c)(3)* of the Internal Revenue Code. Tax-exempt bond financing available to public institutions is also referred to as *municipal bonds*; it is available to nonprofit colleges, universities, and hospitals as *qualified 501(c)(3) private activity bonds*.

Our member organizations use these financial instruments to acquire, construct, renovate, and expand capital infrastructure such as clinics, sheltered workshops, hospitals, academic buildings, residence halls, modern energy plants, museums, and more. In 2016, higher education bond sales reached $18.4 billion and tax-exempt health care bond sales totaled $49.6 billion.[1]

[1] The Bond Buyer Decade in Public Finance statistics.

In general, for institutional borrowers, the interest rate on municipal bonds is significantly lower than on taxable bonds, thus creating beneficial financial terms. Indeed, the interest rate spread between taxable and tax-exempt bonds typically ranges between 150 and 200 basis points. The lower interest rates create significant savings by lowering the financing cost of multi-million dollar construction projects, often financed over a 30-year period. The lower financing cost allows hospitals and health care institutions to keep charges lower than would be the case if taxable financing was used. For colleges and universities, the lower financing cost enables them to keep tuition lower than would be the case if taxable financing was used.

For many institutions, public or private, revenue from operations or from restricted gifts simply does not provide sufficient funds to build, expand, and renovate the physical plant, property, and equipment needs necessary to meet their respective missions, and taxable debt is more costly, often by a material amount.

These organizations employ bonds only after close scrutiny of risk and financial plans and manage them prudently. If an institution holds such tax-exempt debt, it is required to meet significant post-issuance disclosure and compliance requirements.

A number of proposals have been made to Congress to alter the tax treatment of tax-exempt bonds. We believe a cap on the income tax exemption of tax-exempt municipal bond interest, or even a partial tax, will cause investors to demand higher returns, again leading to higher infrastructure costs. Higher borrowing costs can result in diminished investment in infrastructure, higher costs, fewer jobs, reduced public services, increased charges and fees, and constraints on the ability to fulfill public missions.

For example, according to a study conducted by IHS Markit[2], a 28 percent cap on tax-exempt interest exemption, based on average capital spending over the years 2003-2012, would reduce U.S. gross domestic product (GDP) by $8.3 billion per year, costing the nation more than 104,000 jobs and $5.5 billion in labor income annually. A complete elimination of tax-exempt interest would reduce GDP by $23.6 billion and cost 299,000 jobs generating $15.6 billion in labor income.

Proposals to reduce or eliminate the interest tax exemption would cost nonprofits billions more in interest expenses. Nonprofit organizations relied on 501(c)(3) tax exempt financing to raise $554 billion for capital projects from 2003-2012. A 28 percent benefit cap on tax-exempt interest would have increased total interest expenses for nonprofits by $58.2 billion from 2003-2012, while a complete elimination would have cost nonprofits an additional $166.3 billion over that period.

[2] http://www.naheffa.com/uploads/2/9/2/5/29251611/naheffaeconomicimpactreport.pdf

Tax-exempt bond financing for not-for-profits is a proven tool with a decades-long record of success for providing cost-effective vital public services and strengthening communities. Bond issuance for private nonprofit hospitals and universities is typically overseen by a unit of state or local government or a municipal bond conduit authority, which is authorized by the state legislature to issue bonded debt.

A variety of proposals have been made to restrict or alter tax-exempt financing mechanisms. One example is direct pay bonds, such as Build America Bonds (BABs). While these bonds were not available to all nonprofits, many public colleges, universities, and hospitals issued BABs when they were available. While we would need to review the details of any new proposals, we generally support direct pay programs if they are designed with adequate financial support to result in a financial instrument whose total costs are comparable with a tax-exempt bond. Should BABs be reinstated in some form, we support expanding eligibility to include private 501(c)(3) institutions.

However, if continuity of federal subsidy payments is unreliable, as demonstrated under recent sequestration orders, we are skeptical that institutions will see direct pay bonds as a dependable budget and planning tool to lower borrowing costs. We encourage Congress to consider direct pay bonds and other proposals as complements, and not alternatives, to tax-exempt bonds.

As mentioned, a proven and useful reform would be to liberalize the bank deductibility rules in IRC section 265 so that banks would be encouraged to purchase debt from smaller nonprofits (and governments). The term “bank qualified” is generally used to describe a class of municipal securities that enjoy a tax-advantaged status when purchased by commercial banks. This preferential status was granted by the Tax Reform Act of 1986 (the “1986 Act”). Prior to the passage of the 1986 Act, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) allowed commercial banks to deduct 80 percent of the interest expense associated with funds invested in tax-exempt securities. The 1986 Act effectively removed this deductibility for all tax-exempt bonds purchased subsequent to August 7, 1986, except those securities officially designated as “bank qualified.” In effect, the 1986 Act created a tax on tax-exempt interest for banks on nonqualified securities.

The temporary liberalization of these rules in 2009 opened up construction opportunities for thousands of small communities and charities throughout the country. Under current law, a "qualified small issuer" is (with respect to bonds issued during any calendar year) an issuer that issues no more than $10 million of tax-exempt bonds during the calendar year. Qualified tax-exempt obligations are commonly referred to as "bank qualified bonds."

In order to modernize and make this provision more useful, the law should be changed: 1) to apply the bond issuance limits to the borrowers, not the issuers, in cases where state conduit or other similar authorities issue the tax exempt bonds, and 2) to significantly increase the limits on the amount of outstanding debt.

Thank you for your consideration of our views, and for the opportunity to share them with the committee.

Sincerely,

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