Taxation of Nonprofits and the Healthcare Industry in New Mexico

Revenue Stabilization & Tax Policy Committee

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Nonprofits

- What is a “nonprofit” organization?
- New Mexico taxation of nonprofits.
  - Income (corporate).
  - Property.
  - Gross receipts and compensating tax.

What is a "Nonprofit?" – the difference between "incorporation" and a tax-exempt designation

- State nonprofit corporation – §§ 53-8-1 *et seq.*
  - a "corporation" that does not distribute income or profit to its members, officers or directors.
  - Form of business entity.
  - No impact on New Mexico taxation.
  - Predicate requirement to obtain a tax-exempt designation letter from IRS.

What is a "Nonprofit?" – the difference between "incorporation" and tax-exempt designation

- Federally Exempt Organization
  - Qualifying organizations are exempt from federal income tax, except on "unrelated business taxable income" ("UBIT").
  - UBIT is revenue derived from a regular trade or business that is not "substantially related" to fulfilling the organization's exempt function.
    - Example: organization to prevent cruelty to animals offers fee-based pet grooming services to the general public and uses the funds to conduct its exempt activities.

Federally Exempt Organizations

- The common thread:
  - income and profits <u>not</u> distributed to members or individuals and do not inure to the benefit of individuals.
- Most federally exempt organizations do not need to operate at a loss or break-even.
- They can earn revenues is excess of expenses, pay salaries, provide insurance and other employee benefits.

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Federally Exempt Organizations

- IRC § 501(c) exempts 29 types of organizations; additional organizations are exempt under 501(d), (e), (f), (k), 521, and 527:
  - 501(c)(1) – corporations organized under acts of congress (including federal credit unions).
  - 501(c)(2) – title holding companies for exempt organizations.
  - 501(c)(3) – religious, charitable, scientific, public safety testing, literary, educational, amateur sports, animal cruelty prevention.
  - 501(c)(4) – civic leagues.
  - 501(c)(5) – labor, agricultural, or horticultural organizations.
  - 501(c)(6) – business leagues, chambers of commerce, boards of trade, professional football leagues.

New Mexico Income Tax (Corporate)

- Organizations, including religious, educational, and charitable organizations (i.e. 501(c)(3)s), that are exempted from federal income tax are also exempted from New Mexico CIT.
- Neither the federal nor state exemptions extend to UBIT.
  – § 7-2A-4(C).

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Gross Receipts & Compensating Tax

- Nonprofits as “sellers” of goods and services –
  - All 501(c)(3)s and 501(c)(6)s that conduct chamber of commerce, visitor bureau or convention bureau functions are exempt from GRT. § 7-9-29(A) & (B).
  - But the exemption does not extend to “gross receipts” that constitute UBIT for federal income tax purposes. § 7-9-29(C).
    - Note: some 501(c)s may be exempt through other means.
    - Example – federal credit unions exempt by pre-emption.

Gross Receipts & Compensating Tax

- Nonprofits as purchasers of goods and services –
  - 501(c)(3)s are exempt from comp tax on purchases of "property." § 7-9-15.
  - Vendors who sell "property" to 501(c)(3)s may deduct the sales from gross receipts. § 7-9-60(A).
  - Services, including construction services, construction materials, and metalliferous mineral ores are *generally* taxable when purchased by nonprofits.

Property Tax

- All church property not used for commercial purposes is exempt. N.M. Const. art. VIII, § 3.
  - N.M. courts have grafted on an affirmative religious use requirement.
- Property acquired and *used* for <u>educational</u> or <u>charitable</u> purposes is exempt. *Id.*

New Mexico versus Other States – sales taxes on nonprofits

- No uniform system of nonprofit taxation.
  - Sales “by” nonprofits generally taxable/sales “to” nonprofits generally exempt (CO, FL, IL, MA, AZ, PA, TX).
  - Generally taxable on purchases, “cherry-picking” specific nonprofits for exemption (AL, AR).
  - Generally taxable on both purchases and sales, unless the purchase or sale fits into an exemption of general applicability (WA).
  - Sales threshold (VT) – sales to nonprofits generally exempt/sales by nonprofits are exempt if the organization did not sell more than $20,000 in preceding year.

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Gross Receipts Tax and the Healthcare Industry

- There are no experts – New Mexico has a complicated system of taxing healthcare services.
- There is no model – cannot glean a path from other states, as most states do not tax “professional services.”
  - Most state sales taxation of the medical industry focuses on tangibles used or consumed in providing medical services and tangibles delivered as part of the service (prescription drugs, dentures, eyeglasses).
  - Even Hawaii, which has a broad excise tax, exempts hospitals, infirmaries, and sanitaria from tax.

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Tax Policy Malpractice?

- Medical service taxation hinges on numerous, often overlapping, variables:
  - Form of provider (government, nonprofit, for-profit).
  - Type of facility (hospitals, long-term care, outpatient medical services, home health agencies, assisted living).
  - Provider ownership structure (doctor-owned, corporate).
  - Payor (Medicare, Medicaid, TRICARE, Indian Health Service, HMO, Health Insurer, Workers' Comp, Private Pay, Copay).
  - The umbrella under which the service is provided (Commercial Contract Service, Medicare part C).
  - The type of service or product (dialysis, prescription drugs).

Gross Receipts Taxation of Medical Service and Principles of Tax Policy

Principle	Description	Evaluation
Adequacy	Tax system should produce adequate revenue to support necessary public services	Depends on scope and viewpoint
Equity (horizontal)	Similarly situated taxpayers should have similar tax burdens	FAIL
Efficiency	Avoid harm to the private economy and economic growth	Depends on Scope and viewpoint
Simplicity	Taxes should be comprehensible to taxpayers and capable of sound administration for tax collectors	FAIL
Accountability	Tax collections and deviations from the base (preferences) should be measured, quantified, and transparent to evaluate policy	Depends on scope and viewpoint

Equity

Any Government Facility	Any Nonprofit 501(c)(3) Facility	For-Profit "Hospital"	For-Profit "Practice" Doctor-Owned	For-Profit "Outpatient Facility"
All service revenue is exempt from GRT/GGRT. §§ 7-9-13, 7-9-3.2.	All service revenue is exempt from GRT. § 7-9-29.	50% of service revenue is taxable. § 7-9-73.1. 3.775% or 5% credit against remaining GRT. § 7-9-96.1.	Medicare, Tricare, IHS, HMO and insurer receipts deductible. All other revenues taxable. §§ 7-9-77.1, 7-9-93.	All service revenue is taxable.
Purchases of equipment/property are not subject to tax. § 7-9-54.	Purchases of equipment/property are not subject to tax. §§ 7-9-15, 7-9-60.	Purchases of equipment/property are taxable.	Purchases of equipment/property are taxable.	Purchases of equipment/property are taxable.
Construction and other purchased services are taxable.	Construction and other purchased services are taxable.	Construction and other purchased services are taxable.	Construction and other purchased services are taxable.	Construction and other purchased services are taxable.

Equity

- Capitated & fixed payments –
  – The Medicare “payor” deduction (§ 7-9-77.1) only applies to practitioners (and by TRD regulation to corporate practices that are not hospices, nursing homes, or outpatient facilities).
  – The deduction was enacted, in part, because doctors in New Mexico received less in Medicare reimbursements than doctors in surrounding states because of the GRT.
  – But the current limitation means that certain practices within New Mexico receive less than other practices in New Mexico.
- Also consider income and property taxes.

Simplicity and Administrability

- Different taxation structures for different providers.
- Deduction ordering – §§ 7-9-73.1, 7-9-77.1, 7-9-93, and 7-9-96.1 (by default) require that all other applicable deductions be taken first.
- Code-based reporting – 7-9-77.1 and 7-9-93 require taxpayer reporting under specific codes.
- Payor-based deductions – require segregation within each patient account (Medicare, Medicaid, Medi-Gap, Insurance, Private Pay, Copay, Workers' Comp) with receipts from some payors taxable and other payors deductible within each patient account.

Accountability

- If accurate, accountability is good for the payor based deductions due to separate reporting.
  – Also necessary for hold harmless payments.
- Lack of accountability for 50% deduction, nonprofits, and government facilities – i.e. we do not know the potential tax base and the effect of deviations.

The Bottom Line

- The current regime:
  - Is inequitable, complex, difficult (if not impossible) to administer.
  - Questionable revenue adequacy (in isolation) given increased state Medicaid obligations and hold harmless payments.
  - Questionable accountability because the system does not enable a full, transparent understanding of deviations and the potential tax base.

Considerations

- Tweaks versus reform.
- GRT or a new/different tax program.
- State obligations.
- Effect on consumers and access to care and providers.
- Limitations on federal payments.
- The potential tax base.
- Changes in the industry
  - Shifts in service provider organizational structures.
  - Private pay versus federal pay.

Questions