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HEALTHCARE LAWYERS

New Tax Law Increases Cash Flow for Some Health Systems, Restricts It for Others

The healthcare industry is not immune to the effects of the recently-enacted GOP tax law. And, perhaps unsurprisingly, results may vary.

When it comes to for-profit health systems, the new legislation ("Tax Cuts and Jobs Act," enacted into law in December) will likely result in substantial savings for operations already in the black … but it also may add another burden to those systems weighed down by debt, short on cash, or struggling with their investments.

GOP tax law "…bifurcates the winners and the losers"

Jessica Gladstone is senior vice president with Moody's Investors Service. Regarding the new tax law, she had this to say to *Modern Healthcare*: "It actually sort of increasingly bifurcates the winners and the losers in the for-profit hospital industry."

After an analysis of eleven for-profit health systems, Moody's concluded that the companies would collectively experience a tax savings totaling between $700 million and $800 million this year, savings those organizations would not have seen prior to the new law. The savings projected in the report, however, would not be spread out evenly among the systems studied — the bulk of it is expected to go to Universal Health Services (UHS) and Hospital Corporation of America (HCA).

UHS and HCA: among the "winners"

UHS and HCA are extensive hospital chains with headquarters in Pennsylvania and Tennessee, respectively. UHS is in line to see a tax savings of $150 million this year on a roughly $752 million income on around $10 billion in revenue for last year. (Steve Filton, UHS's CFO, has said that the company may ultimately save $50 million more thanks to the law's provision for accelerated depreciation.) And HCA reported around $2 billion in income — on $44 billion in revenue — for last year, and will likely pay $500 million less in taxes this year.

However, health systems carrying substantial debt are not expected to come out ahead in light of the new legislation, at least not when compared to health organizations less burdened by expenses. They may feel like they're slipping further behind when it comes to staying competitive in the market. For example, Texas-based Tenet Healthcare and Tennessee-based Community Health Systems (CHS). Although they can also take advantage of the lower corporate tax rate and deduct capital expenses right away, they are not able to deduct as much interest as they would have before the new law took effect.

Some health systems will see "less free cash flow to invest"

Gladstone (one of the Moody's report's authors) explained this by pointing out that hundreds of millions of dollars in tax savings for an operation will often turn into a reinvestment in the health system's holdings, which in turn hones the organization's competitive edge overall. She added: "Whereas the companies who have already been struggling with investments like Community or Quorum are probably going to be doubly at a disadvantage because they'll have less free cash flow to invest in their markets."

The new tax law restricts the interest expense companies are permitted to deduct — the cap is 30% of the company's EBITDA (earnings before interest, taxes, depreciation and amortization) through 2021. Gladstone noted that companies with interest expenses coming in at a high proportion of their EBITDA will feel the pinch under the new law.

Net operating loss carryforwards will still help reduce tax obligation

However, loss-generating companies are still permitted to leverage those past losses to claim tax-free income in ensuing years (“new operating loss carryforwards”). Therefore, relatively debt-burdened companies like Tenet and CHS, even while limited by the new ceiling on interest expense deductions, will still be able to counterbalance their tax loads going forward.

By way of illustrating this, Tom Aaron, CFO of CHS, told investors during a recent conference call that the health system ended the year with a net operating loss carryforward of $610 million and therefore does not anticipate owing federal cash taxes this year.

Gladstone said: “The change in law might not necessarily lead to an actual increase in taxes for some of these highly-leveraged companies, because many of them have been generating losses for many years and are able to use those to shield income in the future.”