



The Intersection of ESG and Tax for Tax-Exempt Healthcare Organizations



Environmental, social, and governance (ESG) objectives are top of mind for many healthcare organizations and their stakeholders, including board members, executives, employees, patients, bondholders, donors, partners, and communities.

The role of tax in the ESG conversation is not always obvious when an organization is tax-exempt, but an organization's Chief Tax Officer or other tax leader is uniquely positioned to contribute to the organization's ESG strategy. Tax leaders at tax-exempt healthcare organizations have long been engaged in the practice of storytelling—that is, articulating a cohesive and compelling picture of the organization's charitable mission, and gathering and presenting data demonstrating how the organization's activities benefit the community. Tax-exempt tax leaders can embrace this skill set to develop a holistic narrative for their organizations' ESG objectives and accomplishments that integrates tax, health equity initiatives, programs addressing the social determinants of health, charity care, community benefit, and the organization's overall system of mission-driven values and commitments. Taking an integrated approach not only results in a crisper, more compelling narrative; it also leads to more efficient data collection, more effective reporting, and better-informed decisions when allocating resources to ESG-related activities.

Presenting the Organization's Tax Story

For taxable organizations, discussions about tax and ESG tend to focus on the issue of transparency regarding the organization's tax payments and its commitment to an ethical total tax strategy that includes reporting, governance, and the payment of its "fair share" of tax, which are viewed as indicia of good corporate citizenship. For tax-exempt healthcare organizations, the tone of the conversation around tax and ESG will be different,

but the underlying considerations of a transparent and responsible tax posture and strong governance are just as relevant. Some facets that should be included in a tax-exempt organization's tax and ESG conversation include:

- Adopting guiding principles for the organization's legal entity structure and its use of tax-exempt versus for-profit entities
- Maintaining a responsible and transparent posture towards the tax obligations of the organization's for-profit entities
- Providing proper transfer pricing and controls for transactions between the organization's tax-exempt and for-profit entities
- Conducting periodic diligence to identify and report unrelated business activities and taking a responsible stance towards the determination and payment of unrelated business income taxes (for a high-level definition of this and other tax lingo used in this paper, please see the plain language guide in the Appendix)
- Understanding and disclosing the benefits of tax credits, incentives, and subsidies

The payment of tax with respect to an organization's unrelated business activities and the income of its for-profit subsidiaries, if significant, can be part of the organization's ESG narrative. In addition, it is increasingly common for tax-exempt organizations to make "payments in lieu of tax" (PILOTs), which are another important part of an organization's overall picture of community contribution, involvement, and benefit.

While the payment of taxes and PILOTs may be relevant to the organization's ESG narrative, it is also important that the organization demonstrate good stewardship of its tax-exempt status, which it enjoys in order to increase the resources available for the achievement of its charitable purpose. Items to consider include:

- Establishing protocols and review procedures to foster full and ongoing compliance with the obligations necessary to maintain tax-exempt status, including disclosure and other requirements under Section 501(r)
- Maintaining current sales tax exemption certificates with vendors and conducting regular reviews to recover overpayments of tax
- For issuers of tax-exempt bonds, continuing to monitor compliance with post-issuance requirements related to private business use limitations.

These considerations can be synthesized into an integrated framework, with guiding principles that direct the organization's overall approach to tax strategy, risk, and responsibility. Once that framework is articulated, it can be implemented throughout the organization's governance and operations, with procedures that promote transparency and accountability to the organization's stakeholders. A good tax strategy stands on a set of well-defined tax principles, which should be memorialized in a written document. A well-crafted tax strategy will also clearly articulate the role of key stakeholders within the organization, as well as the tax risk management policies and procedures that determine the organization's tax strategy is operationalized and kept current.

Presenting the Organization's Social Commitments Story

There is a broader role that an organization's tax leader can play in unifying the organization's ESG story, particularly with respect to its social or "S" objectives. Presenting a narrative related to the organization's social commitments and charitable mission is fundamental to its status as a tax-exempt organization. A "community benefit" narrative is a key component of an organization's application for tax-exempt status, and plays a recurring role in the qualitative and quantitative disclosure of community benefit that is required each year in the organization's Form 990, including Schedule H.



Over the past ten years, healthcare organizations have been subject to a growing sphere of rules, reporting obligations, and expectations that overlap with the community benefit standard and the reporting that is required on the Form 990, such as:

- Section 501(r), which includes mandatory community health needs assessments (CHNA) and implementation strategies
- Rising demands for action to address health inequity, access to care, and social determinants of health
- State laws that dictate minimum levels of charity care
- Independent organizations that rank hospital systems according to a social responsibility scale that selectively extract data from public sources such as the Form 990, CHNA and financial statements.

Each of the foregoing falls within a sphere of concerns that most would associate with the “S” in ESG, but each one looks at it from a slightly different angle. The opportunity that tax-exempt healthcare organizations have before them is

to leverage their experience with qualitative and quantitative community benefit reporting to address this broader group of constituencies in a holistic fashion. For example, a hospital’s community health needs assessment and implementation strategy might result in the hospital investing in a community program that addresses health equity concerns. If this investment decision is part of a workflow that includes the organization’s tax leaders, the investment can be directed in a way that optimizes how it appears in the organization’s “community benefit” report on its Form 990, which in turn may improve its score in independent rankings of hospital social responsibility.

An organization that does not take a coordinated approach may lose the opportunity to harness the true power of its community health needs assessments, may make investments that do not appear in its community benefit calculation, and may present only a partial or distorted picture of its commitment to the “S” in ESG. But when an organization adopts a unified approach to addressing the concerns of different constituencies, the result is an organization that:



- Speaks with one voice and one story about its social commitments and contributions to its community
- Presents a cohesive set of values aligned to its social, charitable, and strategic mission
- Centralizes its resources to address the growing scope of regulation, reporting, and accountability related to a healthcare organization's response to social concerns
- Relies on a streamlined set of metrics to measure and report its progress in a way that communicates clearly and effectively with all of its stakeholders
- Makes well-informed decisions about how to enhance the impact of its investments in ESG, community health, and related initiatives
- Has its tax strategy and operations aligned to the organization's other ESG priorities, such as decarbonization, medical waste reduction, ethical supply chains, staff diversity and inclusion, etc.

Presenting the Total Story

Social factors tend to be the dominant ESG focus for healthcare organizations, but a comprehensive approach to ESG will also include environmental and governance imperatives, such as energy efficiency, sustainability, cyber security, ethical use of patient data, and diversity and inclusion on boards and senior leadership teams. As healthcare operating models continue to evolve and organizations become more complex, the scope of ESG issues will widen even further. A truly coordinated approach to ESG will bring tax and social responsibilities together at the same table with these other aspects of ESG to articulate the organization's overall ESG story and how it aligns with the organization's mission, vision, and strategy. This unified narrative will help clarify priorities, identify metrics, and drive practical action steps that increase the impact of the organization's investments and initiatives, reinforcing the organization's status as a community leader committed to transparency, community health improvements and a better future for everyone.

For additional KPMG thought leadership discussing ESG strategies and initiatives, please see the following:

ESG in healthcare is the new burning platform
<https://institutes.kpmg.us/healthcare-life-sciences/articles/2021/esg-healthcare-burning-platform.html>

KPMG Impact
<https://www.kpmg.us/services/kpmg-impact.html>



Appendix: A Tax Lingo Glossary

Community Benefit Standard	The community benefit standard is a test that the IRS uses to determine whether a hospital is organized and operated for the charitable purpose of promoting health and thus eligible for tax exemption. Factors range from whether the hospital operates an emergency room that is open to all, regardless of ability to pay, to whether the hospital uses surplus funds appropriately.
Community Health Needs Assessment (CHNA)	A CHNA is a systemic exercise that tax-exempt hospitals are required by the Affordable Care Act to conduct every three years. The purpose of a CHNA is to identify and report on the significant health needs of the community that a hospital serves. In connection with its CHNA, a hospital is also required to adopt an “implementation strategy” that details how it will address the identified health needs.
Form 990 (Return of Organization Exempt From Income Tax)	The Form 990 is a tax form filed by tax-exempt organizations with the Internal Revenue Service. Form 990 is an annual filing, made available to the public, that includes detailed information about the organization’s activities, governance, and finances.
For-Profit	A for-profit entity is an entity that is not tax-exempt. Tax-exempt healthcare organizations commonly use for-profit subsidiaries to hold certain investments or conduct ancillary activities.
Payment in Lieu of Tax (PILOT)	PILOTs are payments made by a tax-exempt organization to a state or (more typically) local government to compensate the government for some or all of the foregone tax revenue (due to an organization’s exemption from property taxes, for example). PILOTs are generally voluntary payments.
Private Business Use Limitation	Hospitals that are financed by tax-exempt bonds are subject to limitations on private business use, which is defined as use of bond proceeds or bond-financed property by a nonqualified user. Management or service contracts with a third-party, for example, can give rise to a private business use concern.
Schedule H (Hospitals)	Schedule H is a supplement to the Form 990 that tax-exempt hospitals are required to complete annually. Schedule H reports qualitative and quantitative information related to the hospital’s financial assistance policy, community benefit spend, community building activities, bad debt and collections policies, and facilities.
Section 501(r)	Section 501(r), which was added to the Internal Revenue Code by the Affordable Care Act, enumerates additional requirements for hospitals to maintain tax-exempt status. These requirements include, for example: periodic Community Health Needs Assessments and implementation strategies, disclosure of financial assistance policies, and limitations on charges and on billing and collection policies.
Tax-Exempt	A nonprofit corporation recognized by the Internal Revenue Service as exempt from federal income tax. Organizations that have received federal tax exemption are also generally exempt from state and local income, property, sales, and other taxes.
Transfer Pricing	Transfer pricing is a methodology used for pricing the transfer of goods or services between related parties in an arm’s-length manner. Situations that may require transfer pricing include transactions between for-profit and tax-exempt entities, regulated and unregulated entities, or entities located in different taxing jurisdictions.
Unrelated Business Income Tax (UBIT)	For tax-exempt organizations, an activity is an unrelated business (and subject to unrelated business income tax) if it meets three requirements: (1) it is a trade or business, (2) regularly carried on, and (3) not substantially related to furthering the exempt purpose of the organization.

Contacts

Monica Coakley

Principal, National Healthcare

Tax Leader

Washington National Tax

T: 615-248-5639

E: mcoakley@kpmg.com

Lori Robbins

Managing Director, National

Healthcare Tax Deputy

Washington National Tax

T: 202-533-3491

E: lorirobbins@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization. NDP353200-1A