Policy Brief

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A Tax Credit Proposal for Profit Moderation and Social Mission Maximization in Long-Term Residential Care Businesses

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Abstract: This policy brief proposes a tax credit with related qualifying conditions that address the serious deficiencies related to abuse and neglect found in the current for-profit long-term care space. It also seeks to address the lack of government accountability for huge outlays of taxpayer dollars in the form of Medicare and Medicaid payments to these facilities, much of which results in maximizing profits for wealthy investors at the expense of vulnerable individuals with limited voice. Our proposed policy arrangement alters the organizational DNA of the for-profit organization, including the moderation of profit, to circumvent the existing financial incentives that are driving the mistreatment and malpractice so evident in the system. It aims to achieve this through four policy components including social financing, a sliding dividend cap, employee-ownership, and limits on complex corporate structures which are tied to a tax credit. This multi-faceted policy idea is intended to start the discussion around a possible path forward.

Keywords: tax credit, nursing homes, employee-ownership, impact investment

For decades for-profit nursing homes and assisted living facilities have seen profit maximization overrun social mission resulting in abuse and neglect of the frail and elderly in these institutions even as they are supported by high levels of tax-payer Medicaid and Medicare dollars. Indeed, numerous studies demonstrate

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that for-profit senior care facilities show higher rates of neglect and abuse when compared with similar nonprofit entities (Comondore et al. 2009). These statistics hold true across time and national boundaries (Brennan et al. 2012) and demonstrate the failure of government oversight regulations to rein in such abuses (Coskun 2022; Silver-Greenberg and Gebeloff 2021). Unfortunately, while nonprofits are said to be more trustworthy than for-profits due to their nonprofit distribution constraint, 70 percent of nursing home providers in the US are for-profit businesses (Goldstein, Silver-Greenberg and, and Gebeloff 2020; Lendon et al. 2019). With personal profit and favorable federal policies incentivizing the creation of greater numbers of for-profit than nonprofit long-term care facilities (Hawes and Phillips 1986), nonprofit trustworthiness can no longer be relied on to drive the growth of higher quality nonprofit facilities. In this policy brief we propose a middle-of-the-road policy solution that moderates profit and maximizes social mission through the qualifying conditions of a moderate tax credit that does not encroach on existing nonprofit sector tax benefits.

Long-term care businesses in the US (see Table 1) often operate under conditions of extreme information asymmetry because those who arrange and pay for the care of vulnerable individuals are not those directly receiving the services (Chou 2002). Market failure theory posits this sets up a “contract failure” situation where the agreement between the seller and buyer results in a less than favorable outcome for the buyer (Powell and Steinberg 2006; Weisbrod 1975). In the long-term care industry this means the buyer unknowingly enters into and continues the purchase of poor quality services for an individual who is not always able to communicate deficiencies in service provision. In these institutions information asymmetry is combined with profit-maximization incentives leading to cost-cutting measures, in particular inadequate and underpaid staffing, that results in poor social care (Gupta et al. 2021). We posit that part of the antidote to this situation is to partially rein in profit maximization. The rationale behind this approach is based on a prescient study by O’Neill et al. (2003) which found that the higher the profit distribution in nursing homes the greater the number of deficiencies in resident care.

More generally, the tax credit and related qualifying conditions proposed in this brief are supported by decades of academic research and investigative journalism that have documented the strong connection between profit maximization in for-profit long-term care settings and poor quality of care (Gandhi, Yu, and Grabowski 2021; Goldstein, Silver-Greenberg and, and Gebeloff 2020; Kahn 2018) with ongoing questions around whether it improves with increased competition (Yang, Yong, and Scott 2021). The most critical of these is the Gupta et al. (2021) report based on rigorous large-dataset analysis which finds that private equity ownership of long-term care facilities increases the short-term mortality of
Medicare patients by 10%. While some few papers have identified policy needs in this space in relation to social enterprise solutions, they have fallen short of specific policy recommendations (Geraghty 2018; Ng, Leung, and Tsang 2020).

Our proposed tax credit addresses a number of hard-to-solve scenarios in the for-profit long-term care space: abuse and neglect due to the lack of accountable oversight built into the organizational DNA; residential homes that are struggling to financially break even and often have poor quality services; the need for an alternative to Medicare/Medicaid funding cuts for homes that have poor quality of care; the desirability of small, residential homes integrated into communities where the elderly live (Cottle 2021) where the economies of scale found in larger homes are not possible; the diversion of Medicare/Medicaid dollars to wealthy investors rather than their reinvestment back into long-term care facilities especially for staffing and living-wage pay. The tax credit may also be of interest to social entrepreneurs seeking both a financial and social return on investment with quality assurance mechanisms built into the structure of the organization. We envision that, after a window where alignment with this tax credit is voluntary, Medicare and Medicaid could phase in the tying of funding to the tax credit’s

Table 1: The long-term residential care industry in the United States.

<table>
<thead>
<tr>
<th></th>
<th>Skilled nursing homes&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Assisted living facilities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of facilities</strong></td>
<td>15,327&lt;sup&gt;a&lt;/sup&gt;</td>
<td>28,900&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
<tr>
<td>% for-profit</td>
<td>70%</td>
<td>78%</td>
</tr>
<tr>
<td>% Nonprofit</td>
<td>23%</td>
<td>21%</td>
</tr>
<tr>
<td>% Government</td>
<td>6%</td>
<td>NA</td>
</tr>
<tr>
<td><strong>Number of residents</strong></td>
<td>1,290,177&lt;sup&gt;a&lt;/sup&gt;</td>
<td>918,730&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
<tr>
<td>% Medicaid&lt;sup&gt;d&lt;/sup&gt;</td>
<td>62%</td>
<td>19%</td>
</tr>
<tr>
<td>% Private Medicare</td>
<td>12%</td>
<td>0</td>
</tr>
<tr>
<td>% Private Pay (includes private insurance)</td>
<td>26%</td>
<td>77%</td>
</tr>
<tr>
<td><strong>Market size</strong></td>
<td>$175.9 billion&lt;sup&gt;b&lt;/sup&gt;</td>
<td>$87.4 billion&lt;sup&gt;d&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

stipulations for all but the highest performing, pre-existing for-profit nursing homes. Stipulations would be tied to health outcome measures that are not self-reported or that rely on the current five-star rating system for Medicare-funded nursing homes (both self-reported measures and the five-star rating system show evidence of manipulation) (Coskun 2022).

To address these situations, we propose a tax credit tied to a novel combination of largely existing policy tools that target the most detrimental aspects of the current for-profit long-term care industry. Drawing on existing policy tools makes it possible to examine the real-world implementation of proposed policy interventions including their successes and failures albeit in different spheres. Our policy brief therefore includes literature reviews around the specific components of the tax credit and consideration of their efficacy as a part of it.

Given the considerable breadth and depth of the needed policy change, this brief focuses on only the heart of the policy: the financial and legal components. We briefly outline these four components and the related tax credit here and then discuss each in the following sections (Table 2 outlines the problems and the proposed financial and legal policy solutions). The first tax credit condition requires that a minimum percentage of investments in the for-profit originate from social financing (social impact bonds and impact investing). This strives to place a social return on investment on equal terms with the economic return on investment to mediate profit maximization with social mission (see Lohr 2021). To provide a more comprehensive social check on the remaining for-profit investment activity, the second condition ties increasing levels of the aforementioned social investment to increasing levels of allowable profit distribution (a sliding dividend cap). The third condition stipulates that the legal form for involved long-term care businesses would be limited to a more trustworthy employee-owned business structure. Fourth, limits would be placed on complex corporate structures that make it difficult to identify accountable parties when there are service quality issues (Kahn 2018). Businesses would be incentivized to enter into the above arrangements through a measured tax credit that would also help subsidize the social mission of the organization. Other potential policy elements not explored in this brief include the implementation of some social mission safeguards found in nonprofits, the direct regulatory restriction of predatory investor practices such as cutting labor costs through reduced staffing and low wages through minimum staffing and wage requirements, and the identification of specific health and social outcome metrics for long-term care businesses though we do address underlying issues related to all of these.
1 Social Financing

To moderate profit maximization in long-term care facilities and to increase accountability, the first policy condition tied to the tax credit requires that a minimum percentage of initial investments in the for-profit long-term care business originates from social financing. This helps ensure that a social return on investment balances the economic return such that profit maximization does not overrun social mission. Social financing is used as an umbrella term to cover many different initiatives to raise funds for social causes with both financial and social returns. These include impact investing, social impact bonds, microfinance and socially responsible investing though here we only focus on the first two since they are the most amenable to financing long-term care facilities (Geobey and Harji 2014; Han, Chen, and Toepler 2020; Rosenman 2019). In general, social financing involves investors like private organizations or wealthy individuals and asset recipients like social businesses, nonprofits, or cooperatives. Each type of social financing has different purposes and traits that differentiate it from the others, varying especially on the emphasis given to financial versus social return (Bugg-Levine and Emerson 2011; Mackey and Sisodia 2012; Rosenman 2019).

First, impact investing, as defined by the Global Impact Investing Network (GIIN), is an investment tool that is “made with the intention to generate positive, measurable, social and environmental impact alongside a financial return.” This means that investors put their money behind businesses that are trying to provide quality products or services and address societal problems. The impact they intend to generate often targets a population in need. Therefore, we propose impact investing as a suitable financing method for the long-term care industry because it can help ensure that the vulnerable elderly population receives the quality service taxpayer money is largely paying for. Admittedly, research on impact investing has surfaced challenges including the lack of management skills among impact investees (Glänzel and Scheuerle 2016) and the lack of a proper legal structure to regulate financial returns and incentives (Burand and Tucker 2019). However, these difficulties are often associated with small social start-ups, while much of the
long-term care industry has experienced management and established regulatory structures that can be drawn upon.

Second, Social Impact Bonds (SIB) provide a way for organizations to raise funds for socially-oriented projects from the backing of private, public, and/or investors interested in philanthropy (Joy and Shields 2013). They are public/private partnerships structured in such a way that the government or other sponsors pay back the investors upon the completion of the stated social objectives, or “Pay for Success” financing (Albertson and Fox 2018; Crowley 2014; Rosenman 2019). Although social impact bonds stand to help social issues, they are relatively new (Crowley 2014; Katz et al. 2018). Between 2010 and 2019, 138 SIBs accounting for US$441 million in capital have been issued globally, ranging in causes from workforce development, to education, and medical services (Hulse, Atun, and McPake, 2021).

SIBs are not without their drawbacks. For example, because SIB creation is dependent on buy-in from private investors, some worry that SIBs may empower private investors to promote social changes that are not as important as those identified by the government (Child, Gibbs, and Rowley, 2016) which could mean there might be insufficient numbers of investors interested in long-term care SIBs. Also, with strong vested interest in social outcomes, social investors may have outsized desires for achievement of social goals (Edmiston and Nicholls 2018). Nonetheless, we believe both impact investing and SIBs could be attractive tools to increase for-profit long-term care facilities’ social accountability due to the ability to identify non-self-reported health outcome measures (Coskun 2022) that can be built into the policy unlike with many other social causes.

Indeed, although there is no consistent way to measure social impact across different industries (Boffo and Patalano 2020), we think it is especially possible to have reliable social impact measures within the long-term care industry because they can be tied to concrete health outcomes (Coskun 2022). The policy could also require that third-party evaluators produce evidence of compliance with pre-established health outcome criteria in order for providers to receive the tax credit. Prior experience shows these measures should not be self-reported. Multiple studies have found that even with the Medicaid/Medicare 5-star rating system, long-term care facilities have manipulated the system by using sleight-of-hand approaches to make their ratings appear higher. In addition, the terms of the social financing could be structured in such a way that there is a security policy for investors to ensure the humane treatment of residents. This could also serve as contingent criteria for the facility to receive the tax credit.
2 Sliding Dividend Cap

As a second qualifying condition of the tax credit, we propose a sliding dividend cap that works together with the social financing component to further moderate profit maximization. The cap aims to limit the overall distribution of profit based on a sliding scale that is dependent on the level of social investment made in the long-term care business. This means a sliding cap would be instituted on the amount of dividends such a business would pay out. Thus, if social financing equaled 20% of overall initial capital investment, the distribution of profit to the remaining 80% representing regular investors would be capped at 40%. On the other hand, if social investments only equaled 15% of overall investment then the distribution of profit to investors representing the remaining 85% would be capped at 35%. Therefore, the greater the amount of social financing found in the organization, the greater the amount of profit distributed to regular investors. In fact, investment money managers have generally found that a dividend payout in the 10–40% range from a typical company’s total earnings signals a sustainable, healthy corporation because the remainder is being reinvested back into the business which should result in better dividends in the future and be of interest to investors (Hicks 2021).

The social financing component combined with the sliding dividend cap seeks to provide a comprehensive social check on for-profit investment activity and ensure that a portion of the profit, often taxpayer Medicaid and Medicare dollars, returns to the organization while still allowing for the potential of a relatively high level of profit distribution to attract investors. The financial return on investment for the socially financed segments would be governed by the unique terms of those instruments.

An asset lock would also be utilized to protect long-term care assets under this policy mechanism from being diverted to for-profits upon dissolution of the entity. Similar to the nonprofit corporation, the asset lock would prevent individuals from using the policy mechanism and associated tax credits to transfer collected assets in the sole service of for-profit projects. Under such an asset lock, any remaining assets would be distributed to similar entities engaged under the proposed long-term care policy mechanism or nonprofits. A cap on interest may also be included.

While the sliding dividend cap relative to social financing is a newly proposed policy idea, static dividend caps on investments are not new and have been implemented in a number of countries as a component of new legal forms for social enterprise though not formally in the US (Liao, Tawfik, and Teichreb 2019). A dividend cap has been in use the longest and most prominently as a component of
the Community Interest Company (CIC) established in 2005 in the United Kingdom (UK) providing an opportunity to examine their use of this policy tool. When a CIC in the UK is incorporated as a for-profit Company Limited by Shares (as opposed to the “nonprofit” Company Limited by Guarantee), a dividend cap puts a limit on the total amount of profit that can be distributed to shareholders by the organization. At present in the UK, the dividend payout to shareholders is capped at 35% leaving 65% of the remaining profit to be reinvested back into the organization or a community purpose. If the CIC does not distribute dividends up to the full 35%, the remaining amount can be carried over to the next fiscal year. The CIC also has an asset lock and an interest cap (Liptrap 2021; Office of the Regulator of Community Interest Companies 2016). A new UK government agency, the Office of the Regulator of Community Interest Companies, was also created to register and monitor CICs.

Those that adopt the CIC as an add-on to the Corporation Limited by Shares legal form – and thereby fall under a dividend cap – are relatively small. By the end of March 2021, there were 23,887 registered CICs in the UK, only 17% of which were Companies Limited by Shares with the potential for a dividend cap (Patton 2021). Critiques of the dividend cap in particular point to low investor interest due to the smaller return on investment, a factor that precipitated the removal of a cap on individual shares in 2014 leaving only the cap on overall payout to shareholders. Assessments of investments following this change are ongoing (Mason 2020) and it remains to be seen where investments will level off. Nonetheless, the experience of the UK’s dividend cap could be studied and built on to create a similar structure in the US long-term care space.

There are several foreseeable challenges for a sliding dividend cap for long-term care businesses. First, as has been seen with the CIC’s dividend cap, the incentive for investors may be muted due to a lower return on investment than could be had in a full profit-maximizing situation. While some investors may view the trade off as justified due to the social return and general long-term health of the organization, others may not be motivated by social outcomes. We believe, nonetheless, that the documented growing interest in impact investing and the ESG (Environment, Social, Governance) movement will help spur investor interest in the financial and social dividends of this approach (Lamy, Leijonhufvud, and O’Donohoe 2021). Second, even if social outcomes are motivating for investors, observers have noted that measuring the social outcomes of social businesses is difficult and unreliable which may discourage large investments (Boeger, Burgess, and Ellison 2018). However, as discussed above, we believe that in the long-term care business there are health metrics that can be monitored more easily and reliably than social outcomes in other fields.
3 Employee-Owned Businesses

Also tied to the tax credit would be a requirement for an employee-owned business structure. This would be an alternative to the typical for-profit structures used in long-term care facilities which lack internal checks and balances and incentives to ward off the poorest quality services. While we previously discussed the general disparity in service quality between for-profit and nonprofit long-term care facilities, the worst offenders are the growing number of facilities supported by large amounts of private equity investment (Braun et al. 2021). Private equity is defined as investment funds that buy and restructure company equity securities that are not publicly traded on a stock exchange (Pradhan 2010). The limited liability mechanism of company law makes it easier for private equities to shield responsibility and channel profits back to investors rather than ensuring adequate staffing and reasonable service quality (Pradhan 2010). The push for short-term returns on investment within about 5 years and the lack of financial transparency (Fenn, Liang, and Prowse 1996; Stevenson and Grabowski 2008) make them what one practitioner called “Almost a Perfect Killing Machine” (Spanko 2020a, 2020b). Indeed, Gupta et al. (2021), using a within-facility difference-in-difference design, estimated that private equity ownership increases the short-term mortality of Medicare patients by 10%, which is accompanied by declines in other measures of patient well-being, such as lower mobility, while taxpayer spending per patient episode increases by 11%.

Employee-owned businesses are offered here as a tested solution to address the worst for-profit accountability and incentive issues, specifically the Employee Stock Ownership Plan or ESOP housed in S and C corporations (cooperatives are a secondary choice because, with the exception of some newer hybrid arrangements, they cannot distribute profits to outside investors who, in the case of long-term care, may be needed to raise the necessary capital). Established in 1974 to encourage businesses to share wealth with employees, an ESOP is essentially a company-funded benefit plan whereby the company contributes or provides debt-purchased shares on behalf of its employees (Hricko and Starr 2014). Businesses are incentivized through tax benefits, the most generous of which accrue to ESOPs in S corporations which “do not have to pay tax on profits attributable to the percentage of the company’s ownership in the ESOP. For example, a 30% ESOP avoids tax on 30% of the profits” (Hricko and Starr 2014, p. 67). Also important, an employee’s shares are subject to vesting, such that the longer employees work the more shares they accumulate with full vesting required at no later than six years of employment (Hricko and Starr 2014).
Research on ESOPs has shown that employees in such companies are more motivated, have higher levels of morale and retention rates as well as greater mutual responsibility and accountability than investor-owned companies (Hricko and Starr 2014; Jenkins and Chivers 2022; Josephs 2021) and, when closely held, they perform well across a range of other benefits for employees and company performance (NCEO 2018). Indeed, with typical investor-owned businesses an inherent conflict-of-interest puts investors on a path that can sacrifice quality and ethical standards in the pursuit of profit (Hazen 2010). Of interest to investors, ESOPs see a per year 2.5% increase in sales, employment, and productivity growth relative to what otherwise would have been expected (Hricko and Starr 2014).

Over the last 10 years a particular type of ESOP arrangement has gained in popularity – the private equity-backed ESOP co-investment (a minority investment where the co-investor has a non-controlling share) (Hricko and Starr 2014; Josephs 2021). This arrangement may work as a component of the long-term care policy mechanism when sizable amounts of outside capital are needed without disrupting the benefits of an ESOP (Josephs 2015). It also offers investors and would-be impact investors a fair number of advantages (Starr 2019). As Stewart states, “ESOP-owned companies have flexible capital structures, can provide market returns for investors, and multiple exit options. All of these characteristics are compatible with private equity, which can make ESOP-owned companies a great fit for private equity investors” (Stewart 2021). We note that any private equity backed co-investment in a long-term care ESOP that is operating within our proposed policy mechanism would be subject to its several checks and balances (including a cap on profit distribution and limitations on corporate complexity) in addition to the private equity component being a non-controlling share.

Shareholders of existing long-term care facilities could potentially benefit from a transition to the ESOP structure in a number of ways including deferment or elimination of capital gains taxes, corporate tax savings, greater cash flow, and more motivated employees (Hricko and Starr 2014). One of the biggest hurdles of such a transition however is the complexity of the transaction involved in creating the ESOP structure (Lument Securities 2021) though there are groups working to streamline the process (Fifty by Fifty 2021).

### 4 Limits on Complex Corporate Structures

In this section, we propose restrictions on the complex corporate structures found in some for-profit long-term care facilities as a fourth tax credit condition since they limit the accountability of owners. The literature on complex corporate structures in relation to poor nursing home service quality implicates three
features of these structures that are often found together: multi-layer shareholding, related party transactions, and chain ownership. We propose limiting all three.

First, multi-layer shareholding makes the chain of accountability longer and harder to hold investors of nursing homes accountable so it is easier for profit-seeking investors to prioritize profits and sacrifice service quality (Kahn 2018). It is defined as ownership that cannot be traced back to natural-person shareholders or beneficial owners within a couple of layers (IDB and OECD 2019). Harrington, Ross, and Kang (2015) conducted a case study of a California nursing home chain and found that complex, interlocking individual and corporate owners and property companies obscured its ownership structure and financial arrangements (see Figure 1). Even for a particular nursing home within this constellation, a multi-layer structure is used to separately set up the operating company and property-holding company. Shielded under the limited liability company law principle, it is extremely hard to get at the individual investors to make them liable for the damages to nursing home residents due to poor service quality. The assets and profits of the operating companies are channeled away, and the liable entity can just claim bankruptcy and the accountability line stops there.

Figure 1: Country villa services corporation structure. (Reprinted from Harrington, Ross, and Kang 2015).
Second, closely tied to private equity are related party transactions found in three-quarters of nursing homes – more than 11,000 – in the US (Rau 2018). Such transactions between related parties, e.g., a holding company, subsidiary companies which share a holding company or shareholders (see also SEC 2017), can be abused in ways such as transacting with unreasonably high prices to shift assets away from the company. Compared with profit distribution to owners, which is reported in standard financial statements, related party transactions can be used to channel away profits in a more hidden way. Compounded by such factors as private equity ownership for which the information disclosure requirement is minimal, this practice often leads to nursing homes being underfunded, which results in understaffing, a shortage of essential supplies and injuries to residents (Duhigg 2007).

Third, chain ownership is also linked to poor service quality in long-term care facilities. Chain ownership is understood as multiple nursing homes that share a brand, central management and common investors (Stevenson, Bramson, and Grabowski 2013). Like a chain store or franchised stores, the constellations of related nursing homes in a chain ownership relationship are complex in the horizontal direction rather than the vertical direction, though in reality many chain ownership structures are complex in both directions and the correlation with private equity ownership is high. Grabowski et al. (2016), studying nursing home data from 1993 to 2010, found that nursing homes in chains of all sizes had many more deficiencies than independent nursing homes did and that low-quality nursing homes were targeted by chains for acquisition. Harrington, Ross, and Kang (2015) also found that a California chain’s nurse staffing was at lower-than-expected staffing levels; its deficiencies and citations were higher than in non-profits; and a number of lawsuits resulted in bankruptcy.

The combination of private equity and chain ownership makes a particularly toxic combination. A study by Harrington et al. (2017), which examines the 5 largest for-profit nursing home chains in 5 countries (Canada, Norway, Sweden, United Kingdom, and the United States), confirms the interactions of chain and private equity ownership and other complex corporate structure features. It finds that large for-profit nursing home chains are increasingly owned by private equity investors, have had many ownership changes over time, and have complex organizational structures. Large for-profit nursing home chains increasingly “dominate the market and their strategies include the separation of property from operations, diversification, the expansion to many locations, and the use of tax havens” (Harrington et al. 2017). These chains have large revenues with high profit margins and often have documented quality problems (Burns et al. 2016; Grabowski et al. 2016).
The restriction of certain ownership structures has not been widely used in tax policies, but one example of a similar requirement is the qualification of an S corporation by the IRS. An S corporation is not a business type, but a tax treatment classification. Unlike traditional C corporations, an S corporation does not pay corporate income tax. Instead, its profits pass through to the owners (IRS 2021). Among the prerequisites for such qualification is a requirement that the owners of an S corporation cannot be “partnerships, corporations, or non-resident aliens”. Although the S corporation shows it is possible to exclude entities with certain types of ownership structures from favorable tax treatment, the main purpose of the S corporation treatment is to simplify tax administration. Comparatively, the tax credit we are proposing is designed to be a policy tool that encourages profit moderation in for-profit nursing homes. As such, a possible roadblock to limiting complex corporate structures is it potentially increases the complexity of the tax credit for the legislators to design, the IRS to administer, and taxpayers to comply with. In addition, the proposed policy may face resistance from powerful interest groups impacted by it, especially private equity holding long-term care businesses with complex corporate structures. However, given the severity of the service quality problems exposed by the pandemic, and the Biden Administration’s commitment to investigate private equity held long-term care facilities (Knight 2022), there should be ample synergy to bring changes to the status quo.

5 Tax Credit

The term “tax credit” under the US taxation system is defined as direct forgiveness of tax owed by the taxpayer, which “reduces tax liability by an amount exactly equal to the credit” (Mikesell 2016). Frequently called “dollar to dollar” reduction of the tax owed, tax credits reduce tax obligations more silently than other tax relief options most of the time and can even reward the taxpayer with cash refunds. Various tax expenditures have been widely used as policy tools on federal, state, and local levels to induce targeted behaviors in the public and achieve certain social policy objectives, such as tax deductions for charitable donations, the exclusion of pension savings at the federal level, the federal level Earned Income Tax Credit, Child Tax Credit and Child and Dependent Care Credit and their corresponding versions in various states. There are also state-level tax credits on unique topics, like the scholarship tax credit programs in 17 states that support school choice for K-12 students (NCSL 2020) and Arizona’s credit for contributions to qualifying foster care charitable organizations.

A tax credit is a suitable policy tool to encourage the socially responsible operation of for-profit long-term care facilities based on at least three
considerations. First, tax credits are more effective in reducing taxpayers’ liability than tax deductions because tax deductions have to coordinate with other deductions taxpayers can otherwise enjoy and it is very likely that the taxpayers cannot enjoy the full benefit under the policy we are proposing. Second, even though it is more favorable than tax deductions, granting tax credits to offset parts of the tax obligations of for-profit long-term care home credits is still less favorable compared with the case of tax-exempted nonprofits, hence it conforms to the horizontal equity principle of taxation. Third, using a tax policy or the tool of tax expenditures is more cost-effective in the sense that it does not require the establishment of a new government agency to administer the policy (Howard 2002).

The structures of tax credit calculation and application vary and can be classified as different types based on several dimensions including its refundability and how it is calculated: flat rate, contingent fixed amount based on a scale, or with sliding bases and rates with some also allowing for alternative calculating methods. Examples of these dimensions are found in such tax policies as the Child and Dependent Care Credit, the Earned Income Tax Credit, and the Research and Development Tax Credit. Each of these types of tax credit feature certain eligible conditions.

Drawing from the multiple possible tax policy configurations, we are able to design the eligibility conditions and calculation mechanisms for a tax credit for long-term care facilities. In the previous sections, we discussed the qualifying conditions element by element, i.e., the sources of social financing, dividend cap, preference for ESOPs as well as the exclusion of long-term care facilities with complex corporate structures as defined above.

The calculation of the long-term care tax credit should support a higher social financing ratio and the related dividend cap discussed previously. In terms of refundability, we suggest the tax credit for long-term care facilities should be refundable because such tax credits are generally considered more equitable across large and small businesses (Batchelder, Goldberg, and Orzag 2006). We thereby ensure that long-term care facilities that do not owe tax or owe tax lower than the credit can enjoy the full benefit of the incentive and ensure horizontal equity across large and small long-term care facilities.

The tax credit has become an increasingly popular policy tool for both policy and political reasons (Benjamin and Posner 2018), and there have been numerous studies evaluating the effectiveness of various types of tax credits. Below we review one such study of a tax credit that most closely aligns with the one we propose.

The Philadelphia Sustainable Business Tax Credit (SBTC) is to date the only tax credit for socially responsible businesses or social enterprises in the US (Mayer 2019). Similar to our proposed tax credit it both purports to encourage businesses
to be more socially oriented and it aligns with a business tax (as opposed to an individual tax). The SBTC was passed by the Philadelphia City Council in 2009, set to function from 2012 to 2017, and be eligible for renewal (City of Philadelphia). As the first local government policy pilot of a tax-incentive for socially responsible businesses, the structural design of the SBTC is relatively simple and has a modest scope. The current SBTC policy is effective through 2022, with recipients eligible for a tax credit up to $4,000, which is nonrefundable and may not be carried forward (Philadelphia Code §19–2604(10)(b)(ii)(a)). The eligibility conditions for SBTC are either to be a certified B Corp (by the B Lab Company) or submit evidence to show the applicant is a “sustainable business” in comparable standards, including “giving substantial consideration to employee, community, and environmental interests in its practices, products, and services” (Philadelphia Code n.d.). Some of the issues with the SBTC include horizontal inequality across small and large businesses due to being nonrefundable and high application transaction costs which devalue gains made through the tax credit received (Devine 2016; Mayer 2019). Nonetheless, the revision and refinement of the SBTC over time indicates the salience of the actual tax benefit enjoyed, the applied taxpayer costs and the accessible scope.

There are several possible problems that could come up in the long-term care setting. The most serious of which is the possibility of gaming the system. Similar to the risk of nonprofits benefiting related parties, recipients of the tax credit may drain away the profits of long-term care facilities through high salaries, related-party transactions and use of an artificially high distribution cap. There is also the possibility of the use of certain kinds of shells to make it appear like there are high social financing ratios.

6 Conclusion

This policy brief outlined the challenges presently found in long-term residential care businesses that facilitate the maximization of profit at the expense of the vulnerable individuals in these institutions. We identified four major issues that work to maintain this situation, proposed four policy ideas to address them, and then tied them to an incentivizing tax credit. First, we identified the need for financial and social goals to be on more equal footing and proposed that a minimum percentage of social financing be used to address this issue. Second, we coupled this with a related sliding dividend cap on the remaining regular investment to reduce the distribution of profit – a factor shown to be tied to deficiencies in long-term care – which also allows for some reinvestment of profit back into the business. This would simultaneously facilitate the reinvestment of a portion of
taxpayer-funded Medicaid and Medicare dollars back into improving the quality of care.

Third, we cited the lack of internal checks and balances and incentives as another issue undermining the quality of care and recommended the employee-owned ESOP structure to address this problem. Fourth, we identified how complex corporate structures facilitate the lack of investor transparency and accountability and the diversion of profit away from adequate investment in facilities including staffing. To address this issue we proposed limitations on complex corporate structures. To incentivize the uptake of these four policy ideas we tied them as qualifying conditions to a federal-level tax credit. To achieve the intended improvement in quality of care for residents in these facilities we believe these policy components need to work together as each has different strengths and covers issues the others do not. As such we do not recommend them as stand-alone policy tools.

Since most of these policy tools have not been used extensively in the long-term care space, if at all, pilot projects are needed to research and test the various policy components, perhaps first in a state-level program. We suggest that governments that seriously consider rolling out this policy mechanism build a program evaluation component into the pilot program to accumulate empirical knowledge around the financial and social costs and benefits of the tax credit. Eventually a well-thought out and locally tested “social responsibility in long-term residential care tax credit” bill could be proposed in Congress. We believe there is quite a bit of potential for this proposed tax credit to be applicable in other fields where there are businesses that share similar characteristics with long-term residential care, namely the for-profit provision of care for vulnerable individuals. These include for-profit hospices, day care centers, group homes for youth and disabled individuals, residential care for those with mental health issues, and prisons, etc.

References


