White House Reviewing Draft Rule Tweaking Fed Provider Tax Waivers

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The White House is reviewing a draft regulation expected to tweak the federal process for determining whether a state can levy provider taxes -- a move likely to upend California and New York budgets and that comes as Congress is considering cracking down on states' ability to finance their share of Medicaid spending by drawing down.

Both California and New York got approval to levy taxes on managed care organizations, even though CMS found that the taxes were higher on Medicaid than non-Medicaid plans, and not generally distributive as required, because the states' request met another statistical test. The agency in December told both states that it would issue new rulemaking to address the situation and warned they may need to change their tax structure to comply with the new regulations.

Paragon Health Institute President Brian Blase, who supports ending or further restricting use of provider taxes and who blasted the Biden administration for approving state financing schemes, says CMS' forthcoming rule is a good start.

"The Trump administration has a lot of Medicaid waste, fraud, abuse, and improper spending to clean up and starting a process to end these managed care tax scams is a very good start," Blase says.

Paragon has warned more states will use the same method to gain approval as California and New York unless the issue is addressed.

The think tank wants Congress to either end states' ability to charge provider taxes -- a change that could save $612 billion over a decade -- or reduce the safe harbor from 6% to 3.5%, which is a policy former President Barack Obama included in his 2012 budget and that Blase estimates could save about $200 billion.
But stakeholders, including nursing homes and hospitals, argue the taxes are a legitimate method for financing Medicaid and any restrictions of the process would trigger harmful cuts to beneficiaries.

The draft rule, "Preserving Medicaid Funding for Vulnerable Populations -- Closing a Health Care-Related Tax Loophole," landed at the White House Office of Management and Budget for review on Saturday (April 19). The rule initially appeared in the Fall 2024 agenda, which said it would “update existing regulations that govern the process for States to obtain a waiver of the statutory requirements that health care-related taxes are broad based and uniform to ensure that taxes passing the statistical test are generally redistributive.”

At issue is states’ ability to charge taxes on certain providers, including hospitals, nursing homes and managed care organizations, and use the revenue to draw down more federal Medicaid matching funds.
Federal law requires taxes to be broad-based and uniform but can seek waivers from those parameters to charge certain providers up to 6% of net patient revenue. Those taxes must also be “generally redistributive,” and the amount of tax cannot be directly related to Medicaid payments, KFF explains in a recent brief.

California requested permission in 2023 to tax managed care organizations (MCOs) to help pay for expanded coverage and reimbursement in Medi-Cal and to establish a state health affordability fund.

In its approval letter to California, CMS said that the tax is higher on Medicaid plans than other MCOs and does not appear generally redistributive as required. The agency made clear that it only approved the request because it had no choice: a rule finalized in 1993 requires any tax that meets a statistical test be automatically approved -- and California met that threshold.

California may need to restructure the tax to comply with future regulations, the agency said.

In 2024, California requested permission to increase the already approved MCO tax --revenue from which the state planned to use to fund coverage for undocumented residents aged 18 to 49, and to remove the Medicaid asset test. CMS once again found the waiver would not be generally redistributive, yet the Biden administration approved the tax based on the process set in the final 1993 rule while reiterating its plans to update that rule.

“By design, this tax disproportionately burdens the Medicaid program while minimizing the tax cost of MCOs that serve relatively low percentages of Medicaid individuals,” the agency said in the December letter. “CMS intends to take imminent action to develop and propose new regulatory requirements through the notice-and-comment rulemaking process to address this issue. Furthermore, CMS recommends that California carefully consider how to mitigate or avoid any possible budgetary and program challenges that could result from the intended rulemaking.”

The agency also gave New York permission to levy an MCO tax and issued a similar warning