CMS Provider-Tax Proposed Rule: Potentially Exceeding Section 71115 in HR1

Executive Summary
July 22, 2026

Overview

Section 71115 of the Working Families Tax Cut legislation establishes new limits on Medicaid health care-related taxes, generally freezing each state's permissible tax percentage at the level enacted and imposed on July 4, 2025. For Medicaid expansion states, the law gradually reduces most provider-tax thresholds from 6 percent in fiscal year 2028 to 3.5 percent beginning in fiscal year 2032. CMS's proposed rule implements these changes but also adds several substantive policies that Congress did not expressly authorize.

The most important legal concern is CMS's proposal to eliminate the existing "75/75 test." Under current regulations, exceeding the percentage threshold does not automatically make a provider tax impermissible. A tax may remain permissible unless at least 75 percent of the taxed providers receive at least 75 percent of their tax costs back through Medicaid or other state payments. CMS acknowledges that Section 71115 does not address the 75/75 test but proposes to discontinue it because the agency believes states could use it to avoid the new limits.

The near-term direct impact of eliminating the 75/75 test may be small because no state currently uses it. Its potential future impact, however, could be very large. It removes the only mechanism states might use to collect provider-tax revenues above their declining statutory thresholds. For an expansion state with a large hospital or managed-care tax base, the loss could amount to hundreds of millions of dollars annually in state tax revenue and a substantially larger reduction in total Medicaid spending once lost federal matching funds are included.

That approach is legally questionable. Congress directed that the newly established "applicable percent" replace "6 percent" within the existing indirect hold-harmless framework. Congress did not direct CMS to delete the second prong of that framework or convert the percentage threshold into an absolute ceiling. The strongest argument against the proposal is therefore that Congress changed the percentage used in the existing test, while CMS is changing the test itself. A policy concern about possible circumvention may not give CMS authority to remove a regulatory protection Congress left in place.

A second major concern is CMS's proposal to create a new tax class for "services of health insurers" and subject that class to all Section 71115 restrictions – meaning new federal oversight. CMS may have general authority to create additional provider-tax classes, but Congress expressly limited the new thresholds to classes listed in 42 C.F.R. §433.56(a) as in effect on May 1, 2025. The proposed health-insurer class did not exist on that date. Applying the July 4, 2025 freeze, zero-percent rule, and expansion-state phase-down to this later-created class arguably disregards an intentional statutory boundary.

Other provisions raise narrower concerns. CMS would treat a tax as "imposed" on July 4, 2025 only if any required federal waiver was also effective by that date, even where state law had already created an enforceable tax obligation. CMS also proposes extensive reporting requirements and could exclude an otherwise qualifying tax from a state's threshold calculation if required data are not submitted. Counting tax-related penalties as tax collections and disallowing all tax revenue within a provider class when aggregate collections exceed the threshold also warrant scrutiny.

Primary Sources

Public Law 119-21, Section 71115 | CMS Proposed Rule | CMS Fact Sheet