Section 71115 and the CMS Provider-Tax Proposed Rule

Analysis of Provisions That May Exceed the Scope of the Statute
July 22, 2026

Primary materials reviewed

Proposed rule (CMS-2452-P): https://public-inspection.federalregister.gov/2026-14897.pdf

CMS fact sheet: https://www.cms.gov/newsroom/fact-sheets/amending-indirect-hold-harmless-threshold-health-care-related-taxes-proposed-rule-cms-2452-p

Public Law 119-21: https://www.govinfo.gov/content/pkg/PLAW-119publ21/html/PLAW-119publ21.htm

42 U.S.C. § 1396b: https://uscode.house.gov/view.xhtml?req=%28title%3A42+section%3A1396b+edition%3Aprelim%29

42 C.F.R. § 433.68: https://www.ecfr.gov/current/title-42/chapter-IV/subchapter-C/part-433/subpart-B/section-433.68

Executive Summary

CMS's July 21, 2026 fact sheet reinforces - rather than resolves - the principal legal concerns with the proposed rule. CMS characterizes the proposal as implementing Section 71115 and codifying statutory limits on new and increased health care-related taxes. But the fact sheet separately identifies several major policy changes that are not expressly directed by Section 71115: eliminating the 75/75 test, creating and regulating a new health-insurer tax class, imposing extensive new reporting requirements, and defining "imposed" to require an effective federal waiver.

The two strongest arguments that CMS has exceeded the statute are:

- Elimination of the 75/75 test, because Congress expressly incorporated the November 1, 2006 version of 42 C.F.R. § 433.68(f)(3)(i), which contained both the percentage test and the 75/75 alternative, and directed CMS only to substitute the new applicable percentages for "6 percent."
- Application of Section 71115 to the newly created health-insurer class, because Congress expressly restricted the new threshold system to classes contained in § 433.56(a) "as in effect on May 1, 2025."

CMS has a more plausible, although still contestable, basis for its definitions, data collection, calculation methodology, and enforcement procedures. The most vulnerable parts of those provisions are the consequences CMS attaches to them - such as excluding a qualifying tax from a state's threshold because of incomplete reporting, withholding approval of Medicaid payment proposals, including punitive penalties as tax revenue, and disallowing all tax revenue within a class when the aggregate amount only slightly exceeds the threshold.

This is a statutory-authority analysis, not a prediction that a court would necessarily invalidate each provision.

What Section 71115 Actually Requires

Section 71115 made a targeted amendment to the existing Medicaid provider-tax statute. Beginning with federal fiscal years on or after October 1, 2026, it directs CMS to substitute a state- and provider-class-specific "applicable percent" for the existing 6 percent indirect hold-harmless threshold.

For non-expansion states, the threshold generally becomes the percentage of net patient revenue represented by a qualifying tax enacted and imposed on July 4, 2025. If no tax was enacted or imposed on that class on that date, the threshold is zero. For expansion states, the July 4, 2025 percentage is subject to a phase-down beginning at 5.5 percent in FY 2028 and reaching 3.5 percent in FY 2032, with exceptions for certain existing nursing-facility and intermediate-care-facility taxes.

Two textual limitations are especially important:

- The new framework applies to classes described in 42 C.F.R. § 433.56(a) "as in effect on May 1, 2025."
- Congress amended the existing statutory incorporation of the indirect-hold-harmless test in the November 1, 2006 version of § 433.68(f)(3)(i), instructing that the new applicable percent be substituted for "6 percent" each place it appears.

The law does not expressly instruct CMS to eliminate the 75/75 test, create a new health-insurer class, define waiver approval as part of "imposition," establish a new reporting penalty, count delinquency penalties as tax collections, or expand classwide disallowances.

1. Elimination of the 75/75 Test Is the Strongest Overreach Issue

What CMS says

The CMS fact sheet states that the agency proposes to discontinue the second prong of the indirect hold-harmless test. Under that second prong, a tax above the percentage threshold may remain permissible unless 75 percent or more of the taxpayers receive 75 percent or more of their tax costs back through Medicaid or other state payments.

The proposed rule acknowledges that Section 71115 "does not address the 75/75 test." CMS nevertheless proposes to eliminate it because states could use the second prong to collect amounts exceeding their new class-specific thresholds. CMS says retaining it could permit states to circumvent the guardrails Congress established.

Why that appears to exceed the statute

CMS's assertion that the law does not address the test is incomplete. Section 1903(w)(4)(C)(ii), as amended by Section 71115, expressly provides that an indirect-guarantee determination must be made under § 433.68(f)(3)(i) as in effect on November 1, 2006. Congress then directed that the new applicable percent be substituted for "6 percent."

The incorporated regulation included the entire two-prong methodology - not merely the first percentage prong. Congress could have converted the applicable percentage into an absolute ceiling or expressly deleted the 75/75 provision. Instead, Congress preserved the regulatory cross-reference and changed only the percentage used within it.

CMS's policy rationale may be understandable, but the agency appears to be replacing Congress's chosen test with a stricter one:

- Congressional approach: Apply the incorporated 2006 test, substituting the new percentage for 6 percent.
- CMS approach: Apply the new percentage as the sole test and prospectively eliminate the second prong.

CMS also acknowledges that the 75/75 test was designed to provide states some flexibility and that Congress did not expressly eliminate it. The agency's concern that states could use that flexibility is a policy objection to the incorporated test, not necessarily statutory authority to delete it.

Assessment: Very strong statutory challenge.

2. Applying Section 71115 to a Post-May 1, 2025 Health-Insurer Class

What CMS says

The CMS fact sheet states that the agency proposes to establish "services of health insurers" as a permissible provider-tax class, thereby bringing existing state taxes on health insurers under CMS oversight and Section 71115 requirements.

The proposed class would include a broad range of commercial insurers, individual- and group-market issuers, short-term limited-duration plans, dental- and vision-only insurers, and potentially certain Medicare Advantage and Medicare Part D premium revenue. Managed care organizations already included in the existing MCO class would be excluded.

CMS concedes that Section 71115 applies to classes "as in effect on May 1, 2025," that the new insurer class would be established after that date, and that Section 71115 does not specify how its thresholds apply to subsequently created classes. CMS nonetheless proposes to subject the new class to the same July 4, 2025 baseline, zero-percent rule, and expansion-state phase-down.

Distinguishing two separate legal questions

CMS likely has general statutory authority to create an additional permissible class. Section 1903(w)(7)(A)(ix) permits the Secretary to establish by regulation other classifications of health care items and services consistent with the statutory framework.

The more serious problem is not necessarily creation of the class. It is application of Section 71115's special restrictions to that class.

Congress repeatedly and deliberately tied the new thresholds to classes listed in § 433.56(a) as of May 1, 2025. The health-insurer class was not on that list. CMS's approach effectively changes the statute from classes described in the regulation as in effect on May 1, 2025 to classes described in the regulation as in effect on May 1, 2025, plus any classes CMS later creates.

CMS calls the statute silent, but the May 1 date can reasonably be read as a deliberate boundary rather than an unresolved gap. Congress knew CMS had general authority to establish additional classes, yet selected a historical version of the regulation.

A more defensible approach would be for CMS to create the health-insurer class under its independent authority and apply the otherwise applicable preexisting provider-tax rules until

Congress specifies a Section 71115 threshold for that new class. Subjecting it automatically to the July 4, 2025 freeze and phase-down is much more vulnerable.

Assessment: Strong statutory challenge to applying Section 71115, although creation of the class itself may be authorized.

3. Requiring an Effective Federal Waiver Before a Tax Is Considered "Imposed"

What CMS says

The CMS fact sheet says "imposed" would mean that the tax was in effect on July 4, 2025 and that any required broad-based or uniformity waiver had been approved with an effective date of July 4, 2025 or earlier.

The proposal otherwise treats the operative question as whether taxpayers were subject to a legally enforceable obligation to pay the tax. But CMS adds that a tax requiring a waiver would not be considered imposed unless the waiver was effective by the statutory date. For example, a waiver effective July 5 would disqualify the tax even if state law made the tax legally enforceable on July 4.

Why that may exceed the law

The statutory text contains three distinct requirements:

- The state had enacted a tax.
- The state imposed the tax on the class.
- The Secretary determined that the tax was within the hold-harmless threshold.

A federal waiver affects whether the tax satisfies federal broad-based and uniformity requirements and whether its revenue may support federal matching funds. It does not necessarily determine whether the state legally imposed the tax on taxpayers.

CMS's definition arguably collapses separate statutory inquiries by making federal waiver status part of the meaning of "imposed." The textual objection is strongest where state legislation created a binding tax obligation by July 4, a waiver request was pending or later approved, the state had no discretion to postpone or cancel the tax, and the waiver's effective date did not exactly coincide with July 4.

CMS can respond that Congress only intended to grandfather federally permissible taxes and that the requirement that the Secretary determine the tax was within the threshold necessarily incorporates waiver status. That makes this issue less clear than the first two.

Assessment: Moderate statutory-overreach concern.

4. Reporting Requirements Are Generally Defensible, but the Consequences May Be Excessive

What CMS says

The CMS fact sheet identifies detailed state reporting as a principal component of the proposal. The rule would require:

- Interim information by December 31, 2026;
- Final actual tax-collection and net-patient-revenue data by June 30, 2028;
- Quarterly reporting thereafter;
- Information about each state and local tax, the use of its proceeds, and associated Medicaid payments; and
- Any additional information requested by the Secretary.

CMS already has provider-tax reporting and Medicaid financial-oversight authority. Requiring information needed to calculate a percentage that Congress directed CMS to determine is therefore probably within the agency's implementation authority.

Where the proposal becomes more questionable

CMS proposes that if a state does not submit the necessary information for a tax, CMS will omit that tax from the state's final threshold calculation, even though CMS recognizes that this could understate the legally applicable threshold.

That consequence is not merely procedural. It can transform a tax that was actually enacted and imposed on July 4, 2025 into one that contributes nothing to the state's permitted baseline. Section 71115 provides a zero-percent outcome when a tax was not enacted or imposed - not when the tax existed but the state submitted incomplete data.

CMS also proposes to withhold approval of state payment proposals when reporting deficiencies prevent the agency from verifying the source of the nonfederal share. That may be reasonable where the missing information is directly necessary to determine the legality of the proposed payment, but a blanket withholding policy could operate as an additional substantive sanction not found in Section 71115.

A more defensible process would allow CMS to:

- Require substantiation;
- Issue an interim or provisional determination;
- Give the state notice and an opportunity to cure;
- Reconstruct the threshold from reliable records where possible; and
- Use ordinary deferral or disallowance procedures for claims that cannot be substantiated.

Assessment: Reporting itself is likely authorized; automatic threshold reduction and broad payment-approval consequences present moderate concerns.

5. Counting Delinquency Penalties as Provider-Tax Collections

The proposed rule would include delinquent tax payments and associated penalty amounts in the numerator used to calculate the applicable percentage. CMS would include penalties even where the

penalty exceeds the underlying tax, as long as the amount was actually recovered and directly associated with tax collection.

Section 71115 bases the applicable percentage on net patient revenue attributable to the qualifying tax. It does not expressly say that civil, administrative, or punitive penalties are themselves tax revenue.

CMS has a plausible administrative argument that penalties are proceeds generated by enforcement of the tax and should not be omitted if omission would understate the state's total collections. The counterargument is that a punitive assessment imposed because of delinquency is legally distinct from the tax itself, particularly when it exceeds the unpaid tax.

Including such amounts could lower a state's permissible future taxing capacity because a temporary enforcement event would be embedded in its statutory baseline calculation.

Assessment: Moderate-to-lower-strength issue, but appropriate for comment.

6. Classwide Forfeiture of All Tax Revenue When the Threshold Is Exceeded

CMS proposes that all taxes imposed on the same permissible class be aggregated. If the aggregate amount exceeds the threshold, all revenues from all taxes within that class would be deducted from Medicaid expenditures - not merely the excess. Thus, if the threshold is 5 percent and combined taxes equal 5.5 percent, CMS would disallow the full 5.5 percent.

CMS says this is longstanding practice and relies on the class-based structure of the existing statutory and regulatory test. That gives the agency a stronger defense than it has for eliminating the 75/75 test.

Nevertheless, Section 1903(w)(1)(A) refers to reducing expenditures by revenues from health care-related taxes involving impermissible hold-harmless arrangements. A state could argue that:

- One tax may be independently compliant;
- A second tax or local assessment caused the aggregate excess;
- Only the offending tax or excess amount should be treated as impermissible; and
- Complete forfeiture is punitive and disproportionate unless Congress clearly required it.

CMS's position is strengthened because the percentage calculation has historically operated at the permissible-class level, rather than as a separate test for each tax.

Assessment: Arguable, but weaker than the 75/75 and health-insurer-class issues.

Provisions That Closely Follow Section 71115

The following portions appear to be straightforward statutory implementation:

- Using July 4, 2025 as the grandfathering date;
- Establishing a zero-percent threshold where no qualifying tax was enacted or imposed on a preexisting class;
- Maintaining the qualifying July 4 percentage for non-expansion states;
- Phasing expansion-state thresholds down to 3.5 percent;

- Preserving the statutory nursing-facility and intermediate-care-facility exceptions; and
- Excluding territories from the amendments.

CMS also has reasonable authority to select data periods, prescribe calculation forms, use interim estimates until actual data become available, and require states to reconcile their reports. Those are the types of details Congress did not specify and that an administering agency ordinarily must address.

How the CMS Fact Sheet Affects the Legal Analysis

The fact sheet is important because it identifies several provisions as independent "proposals," rather than suggesting they are expressly compelled by Congress. In particular, it says CMS is:

- Revising its interpretation of "enacted" and "imposed";
- Discontinuing the 75/75 test;
- Establishing health insurers as a new permissible class and subjecting the class to Section 71115; and
- Establishing new detailed reporting requirements.

That does not by itself prove that CMS lacks authority. Agencies often must make policy choices when implementing a statute. But it undermines any contention that every major component is simply a ministerial codification of Section 71115.

The fact sheet's estimated federal savings of $246 billion over 2026-2035 also demonstrates the proposal's substantial practical consequences, although fiscal magnitude alone does not establish illegality.

Under Loper Bright Enterprises v. Raimondo, a reviewing court must independently determine whether CMS acted within its statutory authority and may not defer to CMS's interpretation merely because the statute is ambiguous. That makes the precise statutory cross-references - the November 1, 2006 regulation and the May 1, 2025 class limitation - particularly important.

Recommended Comment-Letter Position

The strongest comment-letter position is that CMS should finalize the provisions directly necessary to calculate and administer the new percentages, but withdraw or substantially revise the two provisions that contradict explicit congressional boundaries: elimination of the incorporated second-prong test and extension of Section 71115 to a permissible class that did not exist on May 1, 2025.

Final Ranking

Most vulnerable

- Eliminating the 75/75 test - very strong statutory challenge.
- Applying Section 71115 to the new health-insurer class - strong challenge to applying Section 71115.

Meaningful but more contestable

- Defining ‘imposed’ to require an effective CMS waiver - moderate concern.

- Excluding a qualifying tax because of incomplete reporting - moderate concern.
- Withholding payment-proposal approvals for reporting deficiencies - moderate concern.
- Counting tax penalties as tax revenue - moderate-to-lower-strength concern.

More defensible for CMS

- Aggregating state and local taxes by permissible class - generally defensible.
- Disallowing all class revenue after the aggregate threshold is exceeded - arguable, but a weaker challenge.