

## Medicaid Provider Tax Proposed Rule July 2025

On May 15, the Centers for Medicare & Medicaid Services (“CMS”) published the *Medicaid Program; Preserving Medicaid Funding for Vulnerable Populations—Closing a Health Care-Related Tax Loophole Proposed Rule* in the Federal Register (“Proposed Rule”). 90 Fed. Reg. 20578 (May 15, 2023). This Proposed Rule is intended to address a “loophole” in the regulatory statistical test applied to state proposals for Medicaid tax waivers and ensure that non-uniform or non-broad-based health care-related taxes are generally redistributive. ***The Proposed Rule is subject to a 60 day comment period, with comments due July 14, 2025.***

The following provides an overview of the proposed standards and related rationale set forth in Proposed Rule. In short, CMS is not proposing a new mathematical test or statistical standard for waivers of the provider tax broad-based and uniformity requirements; rather, CMS believes “it is necessary to take our analysis a step beyond the mathematical result[s]” to address unintended “loopholes” in the Medicaid provider tax waiver requirements.

### **Background**

Federal statute and regulation specify that a provider tax must be broad-based, uniform, and not hold the assessed providers harmless for the cost of the provider tax. However the Secretary of Health and Human Services (the “Secretary”) is authorized to waive the broad-based and uniformity requirements if the Secretary determines that a state has sufficiently demonstrated that the net impact of the tax is “generally redistributive” and the amount of the tax is not directly correlated to Medicaid payments. See SSA 1903(w)(3)(B) and (C); 42 CFR 433.68(e). A tax will be considered generally redistributive if it satisfies the quantitative tests set forth in regulation – the P1/P2 test for waivers of the broad based requirement and the B1/B2 test for waivers of the uniformity requirement. See 42 CFR 433.68(e)(1) and (2).

In the preamble to the Proposed Rule, CMS notes that the agency previously attempted to address concerns regarding provider tax waivers, particularly waivers of the uniformity requirement, through revisions to the B1/B2 test set forth in the 2019 Medicaid Fiscal Accountability Proposed Rule (MFAR). However, CMS acknowledges that since MFAR was formally withdrawn, CMS has approved certain “problematic” waiver proposals because a state’s health care-related tax waiver proposal satisfied current regulatory requirements to be considered generally redistributive. In approving the waiver requests, CMS sent “companion letters” to the waiver approvals outlining why CMS believed that the taxes did not meet the spirit of the law in terms of being “generally redistributive” and (in some cases) put the States on notice that CMS was contemplating rulemaking in this area.

CMS indicates that it is aware of seven (7) states with problematic provider tax waivers in federal fiscal year 2025. While CMS has been particularly focused on MCO taxes and related waivers of the uniform requirement, CMS makes clear in the Proposed Rule that it is aware of other permissible classes and waiver proposals vulnerable to perceived regulatory vulnerabilities.

### **Proposed Rule**

CMS proposes to retain the mathematical tests set forth at (e)(1) and (e)(2) and add a new paragraph (e)(3) that would apply regardless of whether a tax meets the P1/P2 or B1/B2 tests. Under the proposed (e)(3), the “tax would not be ‘generally redistributive’ ***if it has certain described attributes that are contrary to the tax program being generally redistributive in nature.***” The attributes address **Taxes That Refer to Medicaid Explicitly** and **Waivers that Do Not Refer to Medicaid Explicitly**. CMS proposes the regulation would specify at least one example or scenario that would violate the new requirements, but CMS makes clear that the examples are not intended to provide an exhaustive list of ways a tax might be structured to violate the new requirements.

Proposed Attributes and Examples		
Taxes That Refer to Medicaid Explicitly		
Proposed Regulation	Description/Requirement	Example(s)
42 CFR 433.68 (e)(3)(i)	Within the permissible class, the tax rate imposed on any taxpayer or tax rate group based upon its Medicaid taxable units is higher than the tax rate imposed on any taxpayer or tax rate group based upon its non-Medicaid taxable units (except as a result of excluding from taxation Medicare or Medicaid revenue or payments as described in paragraph (d) of this section) the tax would not be generally redistributive.	An MCO tax where Medicaid member months are taxed \$200 per member month whereas the non-Medicaid member months are taxed \$20 per member month.
42 CFR 433.68 (e)(3)(ii)	If within a permissible class, the tax rate imposed on any taxpayer or tax rate group explicitly defined by its relatively lower volume or percentage of Medicaid taxable units is lower than the tax rate imposed on any other taxpayer or tax rate group defined by its relatively higher volume or percentage of Medicaid taxable units, it would not be generally redistributive.	<p>A tax on nursing facilities with more than 40 Medicaid-paid bed days of \$200 per bed day while nursing facilities with 40 or fewer Medicaid-paid bed days are taxed \$20 per bed day would violate this requirement.</p> <p>A tax on hospitals with less than 5 percent Medicaid utilization at 2 percent of net patient service revenue for inpatient hospital services, while all other hospitals are taxed at 4 percent of net patient service revenue for inpatient hospital services; this tax structure also would violate this requirement.</p>
Waivers that Do Not Refer to Medicaid Explicitly		
Proposed Regulation	Description/Requirement	Example(s)
<p>42 CFR 433.68 (e)(3)(iii)</p> <p>The intent of the proposed regulatory provision is to address potential efforts to mask a provider tax that falls more heavily on Medicaid taxable units using some other terminology or defining factor to circumvent the requirements in (e)(3)(i) and (ii), such as a substitute definition, measure, attribute, or the like as a proxy for Medicaid to accomplish the same effect.</p>	CMS proposes to prohibit a State from imposing a tax that excludes or imposes a lower tax rate on a taxpayer or tax rate group defined by or based on any characteristic that results in the same effect as described in paragraph (e)(3)(i) or (ii). For the same reasons that taxes would violate (e)(3)(i) or (ii), such taxes would not meet the statutory generally redistributive requirement.	<p>The first example involves the use of terminology to establish a tax rate group based on Medicaid without explicitly mentioning “Medicaid” or the State-specific name of the Medicaid program (i.e., a tax on inpatient hospital service discharges that imposes a \$10 rate per discharge associated with beneficiaries covered by a joint Federal and State health care program and a \$5 rate per discharge associated with individuals not covered by a joint Federal and State health care program).</p> <p>The second example concerns the use of terminology that creates a tax rate group that closely approximates Medicaid such as eligibility criteria (income) (i.e., a tax on hospitals located in counties with an average income less than 230 percent of the Federal poverty level of \$10 per inpatient hospital discharge, while hospitals in all other counties are taxed at \$5 per inpatient hospital discharge).</p>

Where the P1/P2 and B1/B2 provide an objective standard for assessing whether a proposed waiver request is generally redistributive, the addition of the proposed “attributes” provides CMS with significant and seemingly arbitrary discretion in determining whether a waiver is generally redistributive. CMS notably refers to the withdrawn MFAR in support of the proposed standards:

***We are proposing to codify this regulatory language with this level of detail directly in response to feedback we received to a similar proposal in the November 2019 proposed rule ... we acknowledge that the level of detail in the November 2019 proposed rule might not have provided enough context to give commenters an accurate picture of our intent. Under the analogous provision of the 2019 proposed rule, we would have determined a tax program not to be generally redistributive if it imposed an “undue burden” on the Medicaid program ... In this proposed rule, we added language to § 433.68(e)(3) to provide reassurance to interested parties that these current proposals are intended only to shut down the loophole to better effectuate the statutory directive that health care-related taxes for which the broad-based and/or uniform requirement is waived must be generally redistributive, and not impact permissible State health care-related tax programs unrelated to this goal. (emphasis added)***

While CMS seems to believe that the new proposed definitions, attributes and examples in (e)(3) improve upon the “undue burden” standard proposed in MFAR, it is unclear whether the proposed attributes and “non-exhaustive” examples will provide greater clarification of the agency’s intent or reassurance that the proposed changes will not impact permissible health care-related taxes.

#### **Transition Period**

States with health care-related tax waivers that do not meet the requirements of paragraph (e)(3), where the date of the most recent ***approval of the waiver occurred two (2) years or less*** before the effective date of the final rule (“Effective Date”), are ***not eligible for a transition period***.

States with waivers that do not meet the requirements of paragraph (e)(3), where the date of the most recent ***approval of the waiver occurred more than two (2) years prior to the Effective Date are eligible for the transition period and must either*** (a) submit a health care-related tax waiver proposal that complies with paragraph (e)(3) with an effective date no later than the start of the first State fiscal year beginning at least one year from the Effective Date; or (2) otherwise modify the health care-related tax to comply with this rule with an effective date not later than the start of the first State fiscal year beginning at least one year from the Effective Date.

#### **Conclusion**

As noted above, comments on the Proposed Rule are due no later than July 14, 2025. It is important to keep in mind that the Proposed Rule does not depend on and is not conditioned on the success of the One Big Beautiful Bill Act (“OBBBA”). While the OBBBA’s “REQUIREMENTS REGARDING WAIVER OF UNIFORM TAX REQUIREMENT FOR MEDICAID PROVIDER TAX” section similarly proposes to amend SSA 1903(w)(3) to impose additional requirements on requests for waivers of the ***uniform*** tax requirement, (1) the Proposed Rule imposes new requirements on waivers of the broad based and uniform requirement respectively; and (2) CMS’ authority to finalize the rule is not conditioned on the success of the OBBBA. As such, it is important to submit comments to the Proposed Rule in addition to all BBB related advocacy efforts.