

DEPARTMENT OF HEALTH & HUMAN SERVICES  
Centers for Medicare & Medicaid Services  
7500 Security Boulevard, Mail Stop S2-26-12  
Baltimore, Maryland 21244-1850



Center for Medicaid and CHIP Services

SHO# 14-001

July 25, 2014

*Handwritten note in a circle: HHS CMS*

**RE: Health Care-Related Taxes**

Dear State Medicaid Director:  
Dear State Health Official:

This letter provides states with information regarding the treatment of health care-related taxes (provider taxes) and their effect on Federal matching funding under Medicaid and the Children's Health Insurance Program (CHIP). The Centers for Medicare & Medicaid Services (CMS) has learned that there may be confusion among states as to what would or would not be considered a health care-related tax.

Section 1903(w)(7)(A) of the Social Security Act (the Act) and implementing regulations identify a number of classes of health care items and services upon which states can impose taxes consistent with other applicable requirements without affecting Federal matching funding. Included among those classes in the original enactment of that section were "services of health maintenance organizations (and other organizations with contracts under section 1903(m))." When the Balanced Budget Act of 1997 changed the statutory terminology for Medicaid managed care, the phrase "Medicaid managed care organizations" was substituted for "health maintenance organizations" as a conforming amendment. This resulted in narrowing the permissible class of services to services provided only to Medicaid beneficiaries, and allowed states to impose taxes that placed a particular burden on the Medicaid program. This language was changed in the Deficit Reduction Act of 2005 (DRA) to return the permissible class to a broader scope that includes a wide range of "managed care organizations" (MCOs). The DRA eliminated states' ability to tax only Medicaid MCOs. In order for a health care-related tax on MCOs to be permissible, after the DRA, the tax would have to apply more generally to all MCOs.

CMS understands that some states may have continued to tax only Medicaid MCO services by incorporating only Medicaid MCOs into larger (often existing) state and local taxes. (See, for example, the May 2014 report from the HHS Office of the Inspector General, available at <http://oig.hhs.gov/oas/reports/region3/31300201.pdf>.) Such taxes could include, but are not limited to, gross receipt taxes, tangible personal property taxes, general use taxes and insurance premium taxes which are otherwise non-health care-related. For the reasons we explain below, CMS is concerned that such taxes are not consistent with applicable statutory and regulatory requirements because they target Medicaid providers and treat such providers differently for purposes of the tax from other individuals or entities. We are also concerned because this targeting is directly related to the underlying health care items or services.

Section 1903(w) of the Act and implementing regulations at 42 CFR Part 433, Subpart B set forth the parameters for health care-related taxes and limits the availability of Federal Medicaid funding when a state imposes health care-related taxes that do not meet certain requirements. These provisions are made applicable to CHIP by section 2107(e)(1)(K) of the Act, and implemented at 42 CFR 457.628.

Section 1903(w)(3)(A)(i) of the Act defines a health care-related tax using multiple tests that must be applied to these types of tax proposals. Health care-related taxes include taxes related to: (1) health care items or services; (2) the provision of, or the authority to provide, the health care items or services; or (3) payment for such items or services. Section 1903(w)(3)(A)(ii) further stipulates that a health care-related tax includes taxes that are not limited to health care items or services but provide for different or unequal treatment for individuals or entities that are paying for or providing health care items or services. Any tax must be fully evaluated against all components of the statutory definition.

Taxing a subset of health care services or providers at the same rate as a statewide sales tax, for example, does not result in equal treatment if the tax is applied specifically to a subset of health care services or providers (such as only Medicaid MCOs), since the providers or users of those health care services are being treated differently than others who are not within the specified universe.

In determining whether a tax is related to health care items or services, section 1903(w)(3)(A) also specifies that if 85 percent of the tax burden falls on health care providers, it is considered to be related to health care items or services. However, this provision does not establish a safe harbor for any tax on health care providers that falls below the threshold. The relationship of such taxes to health care items and services must still be analyzed to determine if there is equal treatment of providers or payers in the design and application of the tax.

CMS advises states that may have such a taxing structure to consider their current practices in light of this guidance and make any changes necessary to achieve compliance as soon as feasible, but no later than the end of their next regular legislative session.

Please contact my staff to facilitate any discussions you would like to have regarding the taxation of health care-related services or items so that we can help you ensure your tax program meets the statutory and regulatory requirements. If you have any questions, please direct them to Kristin Fan, Deputy Director, Financial Management Group at 410-786-4581 or at [Kristin.Fan@cms.hhs.gov](mailto:Kristin.Fan@cms.hhs.gov).

Sincerely,

/s/

Cindy Mann  
Director

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**cc:**

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