

January 7, 2025

CERTIFICATION POSTED ON WWW.DHCS.CA.GOV

Certification of Federal Approval for Modified Managed Care Organization Tax – Effective January 1, 2024

The California Department of Health Care Services (DHCS) issues this certification of federal approval pursuant to Welfare and Institutions Code section 14199.80 et seq.

On December 15, 2023, the Centers for Medicare and Medicaid Services (CMS) approved a waiver of the broad-based and uniformity provisions, pursuant to Part 433.72 of Title 42 of the Code of Federal Regulations (42 C.F.R. § 433.72), for the Managed Care Organization (MCO) tax, effective for April 1, 2023, through December 31, 2026, authorized by California's Assembly Bill (AB) 119 (Chapter 13, Statutes of 2023). DHCS subsequently submitted to CMS a waiver request for a modified MCO tax structure, effective January 1, 2024, as authorized by AB 160 (Chapter 39, Statutes of 2024). CMS approved the modification to California's MCO tax with an effective date of January 1, 2024, on December 20, 2024. A copy of the approval letter from CMS is enclosed.

Pursuant to Welfare and Institutions Code section 14199.84(d)(2), DHCS will issue notice to each MCO subject to the modified MCO tax approved by CMS. For the tax period corresponding to the 2024 calendar year, a supplemental tax amount will be collected for the difference from the previously approved tax model.

Accordingly, as Director of DHCS, and pursuant to Welfare and Institutions Code section 14199.84(d)(1), I hereby certify the receipt of federal approval necessary to claim federal financial participation in conjunction with the modified MCO tax pursuant to AB 160. This approval is effective beginning January 1, 2024, and is applicable through December 31, 2026, subject to any future changes to the federal requirements concerning health care-related taxes that may require California to modify its tax structure to come into compliance. Copies of this certification are being sent via email to the Secretary of State, the Secretary of the Senate, the Chief Clerk of the Assembly, and the Legislative Counsel.

Sincerely,


Michelle Baass
Director

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



Financial Management Group

Tyler Sadwith
State Medicaid Director
Department of Health Care Services
1501 Capitol Ave
MS 0000
Sacramento, CA 95899-7413

DEC 20 2024

Dear Director Sadwith:

This is in response to your request for a waiver of the broad-based and uniformity requirements related to the state of California's Managed Care Organization (MCO) tax. California is requesting this waiver as an update to its previously approved MCO tax. Upon review and consideration of the information formally provided to the Centers for Medicare & Medicaid Services (CMS) on March 27, 2024, and revised on June 30, 2024, I am writing to inform you that your request for a waiver of the broad-based and uniformity provisions of sections 1903(w)(3)(B) and (C) of the Social Security Act (the Act) is approved.

The tax structure for which California requested a waiver would be imposed as follows:

- (i) Cumulative Medi-Cal member months from 0 to 1,250,000, inclusive, are excluded from the tax for Calendar Year (CY) 2024, CY 2025, and CY 2026;
- (ii) Cumulative Medi-Cal member months from 1,250,001 to 4,000,000, inclusive, are taxed \$274.00 per member month for CY 2024, CY 2025, and CY 2026;
- (iii) Cumulative Medi-Cal member months in excess of 4,000,000 are excluded from the tax for CY 2024, CY 2025, and CY 2026;
- (iv) Cumulative other member months from 0 to 1,250,000, inclusive, are excluded from the tax for CY 2024, CY 2025, and CY 2026;
- (v) Cumulative other member months from 1,250,001 to 4,000,000, inclusive, are taxed \$1.75 per member month for CY 2024, \$2.00 per member month in CY 2025, and \$2.25 per member month in CY 2026; and
- (vi) Cumulative other member months in excess of 4,000,000 are excluded from the tax for CY 2024, CY 2025, and CY 2026.

Section 1903(w)(3)(E) of the Act specifies that the Secretary shall approve broad-based and uniformity waiver applications if the net impact of the tax is generally redistributive, and the amount of the tax is not directly correlated to Medicaid payments.

Federal regulations at 42 CFR 433.68(e)(2) describe the statistical test necessary for a state to demonstrate that the proposed structure is generally redistributive. California's statistical

demonstration is addressed below. Moreover, federal regulations at 42 CFR 433.68(f) describe the circumstances in which a direct correlation would exist. Upon review of the California statute implementing the proposed MCO tax and review of California's proposed methodology for increasing Medicaid reimbursement to Managed Care Organizations, it appears that no direct correlation exists between the tax and any associated increases in Medicaid reimbursement. To determine the generally redistributive nature of the proposed member month tax, California calculated the slope (expressed as B1) of a linear regression for a broad-based and uniform tax in which the dependent variable was each MCO's percentage share of the total tax paid, if the tax was uniformly imposed on all member months in the state and the independent variable was each MCO's number of Medicaid member months. California then calculated the slope (expressed as B2) of a linear regression for the state's actual proposed tax program in which the dependent variable was each MCO's percentage share of the total tax paid and the independent variable was the number of Medicaid member months for each MCO.

Using the member month and tax rate data you provided, CMS also performed the calculations required in the regulations for the proposed tax. CMS finds that the result of the generally redistributive calculation for the California MCO tax to be **1.2900** for calendar year 2024, **1.2901** for calendar year 2025, and **1.2902** for calendar year 2026.

Therefore, we are able to approve your request for a waiver of the broad-based and uniformity provisions of section 1903(w)(3)(B) and (C) of the Act for the proposed MCO tax. Please be advised that any future changes to the taxing structure, including a non-uniform change to the approved tax rates, may require the state of California to submit a new broad-based and/or uniformity waiver request.

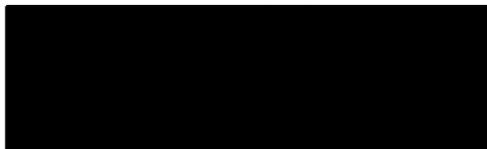
Federal regulations at 42 CFR 433.72(c)(2) specify that a waiver will be effective for tax programs commencing on or after August 13, 1993, on the first day of the calendar quarter in which the waiver is received by CMS. CMS received the state of California's request for a waiver of the broad-based and uniformity requirements on March 27, 2024, with a requested effective date of January 1, 2024. Therefore, the effective date of California's request for a waiver of the broad-based and uniformity requirements is January 1, 2024. Please be advised that any changes to the federal requirements concerning health care-related taxes may require the state to come into compliance by modifying its tax structure.

CMS is also providing a companion letter to this tax waiver approval letter that informs the state that CMS is currently contemplating proposing regulatory changes through the notice-and-comment rulemaking process that could have an impact on California's MCO tax if finalized. Please be advised that any changes to the federal requirements concerning health care-related taxes may require the state to come into compliance by modifying its tax structure.

CMS reserves the right to perform a financial management review at any time to ensure that the state operation of the tax on nursing facilities continues to meet the requirements of section 1903(w) of the Act.

I hope this information addresses all your concerns. If you have further questions or need additional information, please contact Matthew Schoonover at (667) 290-8843.

Sincerely,



Rory Howe
Director
Financial Management Group

DEPARTMENT OF HEALTH & HUMAN SERVICES
Centers for Medicare & Medicaid Services
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Financial Management Group

Tyler Sadwith, State Medicaid Director
Department of Health Care Services
1501 Capitol Ave
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Sacramento, CA 95899-7413

DEC 20 2024

Dear Director Sadwith:

This letter is being sent as a companion to our approval of California's request for a waiver of the broad-based and uniformity requirements under sections 1903(w)(3)(B) and (C) of the Social Security Act (the Act) for the state's Managed Care Organization (MCO) tax.

As you are aware from our earlier communication regarding California's previous MCO tax, the Centers for Medicare & Medicaid Services (CMS) is concerned that California's existing MCO tax and recent waiver request imposes a significantly higher tax rate on Medicaid member months than on comparable non-Medicaid member months. As described in detail below, this approach could be viewed as conflicting with the statutory requirement that the Secretary of Health and Human Services only approve tax waiver requests that are "generally redistributive in nature." By design, this tax disproportionately burdens the Medicaid program while minimizing the tax cost of MCOs that serve relatively low percentages of Medicaid individuals. 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 CMS' intended rulemaking.

CMS conducted a review of the state's waiver request and determined that the state's tax would impose a much higher tax burden on Medicaid member months compared to non-Medicaid member months. Specifically, Medicaid member months comprise about 50% of all member months but experience over 99% of the total tax burden. Section 1903(w)(3)(E) of the Act provides, as relevant here, that the Secretary shall approve a health care-related tax waiver for the broad-based and/or uniformity requirements if the net impact of the tax and associated Medicaid expenditures is "generally redistributive in nature." Implementing regulations in 42 CFR § 433.72(b) require that, "for CMS to approve a waiver request, the state must demonstrate, to CMS's satisfaction," that "[t]he net impact of the tax and any payments made to the provider by the state under the Medicaid program is generally redistributive, as described in § 433.68(e)[.]" In turn, 42 CFR § 433.68(e) specifies two statistical tests for determining whether a given tax waiver request would result in a tax program that is "generally redistributive," with the applicable test depending on whether the state is requesting a waiver of the broad-based requirement only or is requesting a waiver of the uniformity requirement (whether or not the state also is seeking a waiver of the broad-based requirement). Because California requested a

waiver of the broad-based and uniformity requirements, the applicable statistical test is specified in 42 C.F.R. § 433.68(e)(2) and is referred to as the “B1/B2 test.”

CMS, then known as the Health Care Financing Administration, implemented the statistical test approach in a 1992 interim final rule with comment period, 57 Fed. Reg. 55118 (Nov. 24, 1992) (1992 IFC). In preamble to the 1992 IFC, we explained that we intended this approach “to balance our desire to give states some degree of flexibility in designing tax programs with our need to preclude use of revenue derived from taxes imposed primarily on Medicaid providers and activities.” *Id.* at 55128. “For purposes of these regulations,” we explained, “we have interpreted the term ‘redistributive’, as used in the statute, to mean the tendency of a state’s tax and payment program to derive revenues from taxes imposed on non-Medicaid services in a class of items or services (or providers of these services), and to use these revenues as the state’s share of Medicaid payments. To the extent that a tax is imposed more heavily on providers with low Medicaid utilization than high Medicaid providers, the tax would be considered redistributive.” *Id.*

We finalized the statistical tests in a 1993 final rule, 58 Fed. Reg. 43156 (Aug. 13, 1993). In the preamble to the final rule, we confirmed the interpretation of the concept of “generally redistributive” described in the 1992 IFC. Specifically, we stated that “our definition of ‘generally redistributive’ is the tendency of a state’s tax and payment program to derive revenues from taxes imposed on non-Medicaid services in a class and to use these revenues as the state’s share of Medicaid payments.” *Id.* at 43164.

California’s tax on MCOs, due to its tendency to derive revenues from Medicaid, does not appear consistent with the definition of “generally redistributive” as defined in the preambles to the 1992 IFC and the August 1993 final rule. California’s tax derives revenues mainly from Medicaid services (instead of non-Medicaid services) and uses these revenues as the state’s share of Medicaid payments. Accordingly, we are concerned that this tax program fails to be “generally redistributive in nature.” However, CMS is approving California’s request for a waiver of the broad-based and uniformity requirements because the state’s proposal meets the applicable statistical test specified in 42 CFR § 433.68(e)(2), with a B1/B2 value of at least 1. As specified in 42 CFR § 433.68(e)(2)(ii), where the state demonstrates to the Secretary’s satisfaction that the value of B1/B2 is at least 1, “CMS will automatically approve the waiver request.”

For the reasons described above, the result of the statistical test, in this instance, does not appear consistent with either the definition of generally redistributive or reflective of the expected results based on the intended design of the statistical test. As outlined above, CMS intends to develop and propose new regulatory requirements through the notice-and-comment rulemaking process to address this issue. As with any notice-and-comment rulemaking process, the public at large, including the state of California, would have the opportunity to provide any comments or input on any proposed changes to current regulations. Please be advised that any future changes to the federal requirements concerning health care-related taxes may require the state of California to come into compliance by modifying its tax structure.

If you have any additional questions or need further assistance, please contact Matthew Schoonover at (667) 290-8843.

Sincerely,



Rory Howe
Director
Financial Management Group