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Department of Health Care Services



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GOVERNOR

February 10, 2020

Mr. Calder Lynch
Acting Deputy Administrator and Director
Center for Medicaid & CHIP Services
Centers for Medicare & Medicaid Services
7500 Security Boulevard, Mail Stop S2-26-12
Baltimore, MD 21244-1850

**CALIFORNIA REQUEST FOR WAIVER FOR MANAGED CARE ORGANIZATION
TAX UNDER MODIFIED MODEL**

Dear Mr. Lynch:

On January 30, 2020, the California Department of Health Care Services (California) was notified that CMS had denied its September 30, 2019, request for a waiver of the broad-based and uniformity requirements in connection with the Managed Care Organization (MCO) tax enacted pursuant to California Assembly Bill 115 (Chapter 348, Statutes 2019). The reason cited was the potential appearance of a hold harmless arrangement due to an alleged correlation between Medicaid payment and tax liability in the proposed variable rate structure.

Relying on our modification authority granted in AB 115, California submits this updated request for a waiver of the broad-based and uniformity provisions, pursuant to 42 CFR §433.72, for the modified MCO tax structure described herein and in the enclosed model. California requests approval for the same taxing period of July 1, 2019, through December 31, 2022, as was requested in the initial September 30, 2019, submission.

Based on the concerns cited in your January 30, 2020, letter, California has made the following modifications to the tax structure:

- Adding a new, initial tier to the Medi-Cal category where Medi-Cal member months from 0 to 675,000, inclusive, are taxed at \$0.00 for the entirety of the taxing period.
- Reducing the range of cumulative member months in the initial tier of the Other category to 0 to 675,000, inclusive, to align with the new initial Medi-Cal tier.

- Cumulative Other member months from 675,001 to 4,000,000, inclusive, are now taxed at \$1.00 for SFYs 2019-20 and 2020-21 and at \$1.50 for SFYs 2021-22 and 2022-23.

With these changes, California believes any appearance of or potential for a hold harmless arrangement has been cured. The cumulative enrollment used in both the Medi-Cal and Other tiers are now identical. As a result, both Medicaid and non-Medicaid plans incur no tax liability in the 0 to 675,000 range, while both Medicaid and non-Medicaid plans incur tax liability in the 675,001 to 4,000,000 range. Thus, any perceived correlation between MCO tax liability and receipt of a Medicaid payment by plans has been eliminated. We note this modified tiering structure is consistent with that of MCO taxes recently approved in other states. In addition, these modifications are substantially similar to those made by California to obtain approval for the previous MCO tax (July 1, 2016, to June 30, 2019).

The terms of the modified MCO tax for which the waiver is sought are as follows:

- (i) Cumulative Medi-Cal member months from 0 to 675,000, inclusive, are taxed at the following rates: \$0.00 in state fiscal year (SFY) 2019-20; \$0.00 in SFY 2020-21; \$0.00 in SFY 2021-22; \$0.00 in SFY 2022-23.
- (ii) Cumulative Medi-Cal member months from 675,001 to 4,000,000, inclusive, are taxed at the following rates: \$40.00 in state fiscal year (SFY) 2019-20; \$45.00 in SFY 2020-21; \$50.00 in SFY 2021-22; \$55.00 in SFY 2022-23.
- (iii) Cumulative Medi-Cal member months in excess of 4,000,000 are taxed at the following rates: \$0.00 in SFY 2019-20; \$0.00 in SFY 2020-21; \$0.00 in SFY 2021-22; \$0.00 in SFY 2022-23.
- (iv) Cumulative Other member months from 0 to 675,000, inclusive, are taxed at the following rates: \$0.00 in SFY 2019-20; \$0.00 in SFY 2020-21; \$0.00 in SFY 2021-22; \$0.00 in SFY 2022-23.
- (v) Cumulative Other member months from 675,001 to 4,000,000, inclusive, are taxed at the following rates: \$1.00 in SFY 2019-20; \$1.00 in SFY 2020-21; \$1.50 in SFY 2021-22; \$1.50 in SFY 2022-23.
- (vi) Cumulative Other member months in excess of 4,000,000 are taxed at the following rates: \$0.00 in SFY 2019-20; \$0.00 in SFY 2020-21; \$0.00 in SFY 2021-22; \$0.00 in SFY 2022-23.

The value for the B1/B2 test in this modified model is 1.0008 for SFY 2019-20, 1.0001 for SFY 2020-21, 1.0018 for SFY 2021-22, and 1.0012 for SFY 2022-23.

Aside from the above described modifications, the MCO tax structure remains the same as described in the initial September 30, 2019, submission. The MCO tax model is based on enrollment in each applicable health plan using data for the January 1, 2018,

through December 31, 2018, year. For the final six months of the proposed model (July 1, 2022, through December 31, 2022), each health plan's MCO tax amount is calculated for the full fiscal year and then divided by two. Please note that, pursuant to federal law and requirements, the MCO tax is not assessed on Medicare managed care enrollment or on enrollment under the Federal Employees Health Benefits Act. Aside from these federal coverage programs, the modified model does not exempt any other full-service health care plan within the applicable MCO provider class from the tax.

Waiver Justification: We believe the modified MCO tax proposal satisfies the criteria for waiver under 42 C.F.R. §433.72(b), as summarized below:

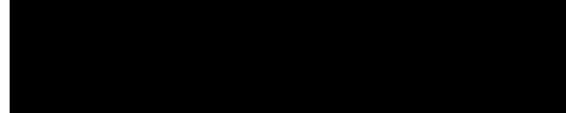
- The net impact of the tax is generally redistributive, as demonstrated by the results of the B1/B2 test set forth above and in the enclosed model.
- The amount of the tax is not directly correlated to Medicaid payments, and the tax is applied to both Medicaid and non-Medicaid lines of business and to both plans that do and do not participate as Medicaid managed care plans.
- The MCO tax does not fall within the hold harmless provisions specified in 42 C.F.R. §433.68(f):
 - The State does not provide for any direct or indirect non-Medicaid payment to health plans paying the tax that is positively correlated with either the tax amount or the difference between the Medicaid payment and the tax amount.
 - Any portion of the Medicaid payment to the MCO taxpayer that varies based on tax amount is attributable to federal requirements for setting actuarially sound capitation rates for Medicaid managed care plans.
 - There is no direct or indirect guarantee by the state to hold MCO taxpayers harmless for all or any portion of the tax amount, and the aggregate revenue from the tax will not exceed six percent of MCO revenues projected for the taxing period.

In addition, please note that this current version of the MCO tax legislation did not extend the other tax changes (i.e., to the state's corporate franchise tax as applied to health plans, and gross premiums tax on insurers) that accompanied the MCO tax approved for the July 1, 2016, to June 30, 2019, period.

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We have provided the modified MCO tax model along with this submission that demonstrates the revised taxing structure and the B1/B2 test results. We would be pleased to provide any additional information that you require for processing this request. We look forward to your favorable response.

Sincerely,



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Chief Deputy Director
Health Care Programs
State Medicaid Director

cc: Karen Shields
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