

DEPARTMENT OF HEALTH CARE SERVICES PROPOSED TRAILER BILL LEGISLATION

Managed Care Organization Tax FACT SHEET

Issue Title: Managed Care Organization Tax. The Department of Health Care Services (DHCS) proposes the renewal of an MCO Tax effective January 1, 2027, that conforms with new and more stringent, federal requirements in H.R. 1.

Background: Assembly Bill (AB) 119 (Committee on Budget, Chapter 13, Statutes of 2023), as amended by Senate Bill (SB) 136 (Committee on Budget and Fiscal Review, Chapter 6, Statutes of 2024) and AB 160 (Committee on Budget, Chapter 39, Statutes of 2024), authorized an enrollment-based MCO tax for April 1, 2023, through December 31, 2026. As of the 2026 calendar year tax period, the tax is designed to generate net revenues of more than \$7.6 billion per year to support the Medi-Cal program and provider payment increases and investments.

Proposition 35, approved by the voters through the November 2024 General Election, governs the uses of the AB 119 tax revenue beginning with the 2025 tax year. The additional revenues associated with SB 136 and AB 160 are not subject to Proposition 35. In addition, Proposition 35 requires that the state continue a substantially similar tax on and after January 1, 2027, but limits the annual non-Medicaid tax liability under that tax to \$36 million.

H.R. 1 (Public Law No. 119-21, 139 Stat. 72) significantly constrains state options to impose health care-related taxes and prohibits taxes that assess higher tax rates on Medi-Cal plans than commercial plans or otherwise place a disproportionately high tax burden on Medi-Cal plans. California's current MCO tax will remain in effect through December 31, 2026, but the federal government will not approve a renewal of the current tax structure due to the H.R. 1 requirements that make it impermissible after that date. Among other changes, H.R. 1 prohibits taxes that impose a higher tax rate on Medicaid or on taxpayers with higher Medicaid volumes, or that are otherwise structured in a way that results in the same effect, effective July 4, 2025. On February 2, 2026, the federal Centers for Medicare & Medicaid Services (CMS) published a final rule that codified these requirements in federal regulations and, further, provided transition periods for existing health care-related taxes that are no longer compliant under H.R. 1,



including California's MCO tax. The transition period to bring California's MCO tax into compliance with H.R. 1 ends on December 31, 2026.

Justification for the Change: DHCS will seek federal approval of a substantially similar MCO tax as required by Proposition 35 by no later than December 31, 2026. The federal government is expected to decline to approve this tax upon determining that it does not conform with H.R. 1 requirements. DHCS proposes to establish and concurrently seek federal approval to continue an alternative, federally compliant MCO tax effective January 1, 2027, in order to maintain ongoing support for the Medi-Cal program, as outlined below:

- DHCS's costs of administering the MCO tax and associated expenditures not to exceed \$4 million annually;
- The nonfederal share of increased capitation payments to Medi-Cal managed care plans (MCPs) accounting for their projected tax obligation;
- The nonfederal share of sustaining 2024 targeted rate increases for primary, maternal, and behavioral health services at 87.5 percent of applicable Medicare rates, currently estimated at about \$300 million annually; and
- The nonfederal share of Medi-Cal managed care rates for health care services furnished to children, adults, seniors and persons with disabilities, and persons dually eligible for the Medi-Cal program and the Medicare Program, in the amount of at least \$2 billion annually.

The tax would be in effect for the 2027, 2028, and 2029 calendar years, subject to certain conditions, with the following characteristics:

- Consistent with the current MCO tax, the new tax will be assessed on countable enrollees of Medi-Cal MCPs and non-Medi-Cal full-service health plans that are licensed by the Department of Managed Health Care under the Knox-Keene Health Care Service Plan Act of 1975.
- Consistent with the current MCO tax, countable enrollees will exclude individuals enrolled in a Medicare plan, plan-to-plan enrollees, as defined, and individuals enrolled in a health plan pursuant to the Federal Employees Health Benefits Act of 1959 (Public Law 86-382, 73 Stat. 708).
- The "base year" for the enrollment data for the 2027 calendar year tax period will be the 12-month period of January 1 through December 31, 2024, or January 1 through December 31, 2025. For subsequent tax periods, DHCS may update the base year to the extent consistent with requirements of federal law or regulations or necessary to obtain or maintain federal approval or ensure federal financial participation is available or is not otherwise jeopardized.
- All revenues, less refunds, derived from the tax will be deposited in the newly-created Medi-Cal Stability Fund and used for the above-described purposes.



- DHCS will establish a schedule for quarterly tax collections and communicate this schedule to health plans subject to the tax within specified timeframes.
- Interest and penalties will be assessed, except when waived by DHCS, on health plan tax obligations that are not paid by the applicable due dates or as otherwise specified.
- The tax amount for each health plan will be \$8.85 per countable enrollee per month, unless DHCS calculates an alternative tax amount or amounts, within specified limits, to align projected revenues generated by the tax to the tax's funding goals or to establish taxing tiers, or otherwise makes any other permissible modification or adjustments to the extent necessary to meet the requirements of federal law or regulations, to obtain or maintain federal approval, or to ensure federal financial participation is available or is not otherwise jeopardized.
- DHCS will consult with affected health plans on any alternative tax amount or amounts or modification or adjustment, as applicable, and must notify affected health plans, the Department of Finance, the Joint Legislative Budget Committee, and applicable Senate and Assembly committees within specified timeframes.

In addition, DHCS' proposal would add specified legislative findings and declarations, define various terms for the purposes of this article, grant DHCS the authority to implement the article by means of provider bulletins, all plan letters, or other similar action without taking regulatory action, specify the effective date of the tax, operative effects of the article, the operative date of the article, as well as provisions that govern the circumstances under which taxes, interest, and penalties imposed under the article shall continue to be due and payable, when the article is inoperative for specified reasons.

Lastly, DHCS proposes to amend Welfare and Institutions Code (WIC) Section 14105.201, which authorizes targeted rate increases for primary, maternal, and behavioral health services, that would:

- Require DHCS to direct Medi-Cal MCPs to reimburse eligible providers in accordance with the provisions of this section (WIC Section 14105.201(b)(2)(A));
- Authorize DHCS to discontinue directed payments when it is no longer necessary to achieve, in aggregate, the reimbursement levels targeted by this section (WIC Section 14105.201(b)(2)(B)); and
- Make other technical changes aligned with this proposal and to remove provisions that are inoperative or inapplicable as of January 1, 2025 (WIC Section 14105.201(c)(1), (d), and (g)(1)).

Summary of Arguments in support:



- The proposal directly supports and funds the Medi-Cal program.
- The proposal utilizes the transition period afforded to California by H.R. 1 and subsequently adopted federal regulations to continue a health care-related tax on MCOs following the expiration of the current MCO tax.
- The proposal helps address the budget shortfall by providing a revenue source to fund services in the Medi-Cal program.

BCP or Estimate Issue # and Title: 4260-404-ECP-2026-MR, Managed Care Organization Tax.