Issue Brief

FEDERAL ISSUE BRIEF

Analysis provided for MHA by Larry Goldberg, Goldberg Consulting

July 22, 2026

CMS Proposes Medicaid Indirect Hold Harmless Threshold of Health Care-Related Taxes

The Centers for Medicare and Medicaid Services (CMS) have issued a proposed rule implementing Section 71115 of the ***"One Big Beautiful Bill"*** also known as the ***"Working Families Tax Cut"*** (WFTC) legislation enacted July 4, 2025.

Effective October 1, 2026, section 71115 establishes new indirect hold harmless thresholds for health care-related taxes (sometimes referred to as provider taxes) generally based on taxes that were enacted and imposed as of July 4, 2025.

The proposed rule would implement new indirect hold harmless requirements and codify the statutory limits on new and increased health care-related taxes established by section 71115. Currently, 49 States and the District of Columbia have at least one health care-related tax.

The 118-page proposal was issued on July 21. It is scheduled for publication in the July 23 ***Federal Register.*** A display copy of the rule is available at: https://public-inspection.federalregister.gov/2026-14897.pdf. A comment period ending September 21 is provided.

The Medicaid Voluntary Contribution and Provider Specific Tax Amendments of 1991, enacted December 12, 1991) amended section 1903 of the Act to specify limitations on the amount of Federal financial participation (FFP) available for medical assistance expenditures in a fiscal year when States receive certain funds donated from providers or certain related entities, and revenues generated by certain health care-related taxes.

Comment

This is another proposal without a table-of-contents. The following table-of-contents was created based on the display copy of the rule.

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Background

Section 71115(a) of the WFTC legislation replaces the previous "6 percent" threshold with an amount calculated generally based on the percent of net patient revenue attributable to the permissible class for which a health care-related tax was enacted by a State or unit of local government, and that State or locality imposes such tax as of July 4, 2025. If a State or unit of local government has not enacted and imposed such a tax for the permissible class as of July 4, 2025, the applicable percent for that class is zero percent.

If the tax exceeds the 6 percent threshold, CMS will evaluate the tax under the second prong of the test, referred to as the "75/75 test." This prong measures if, in the aggregate, 75 percent of taxpayers receive 75 percent or more of their total tax costs back in enhanced Medicaid payments or other State payments.

Starting FFY 2028, the applicable threshold for each permissible class will be the lower of the July 4, 2025, calculated threshold, or the applicable percent for the FFY (5.5 percent in FFY 2028, decreasing by 0.5 percentage points annually until reaching 3.5 percent in FFY 2032).

For example, if an expansion State has a threshold of 4.7 percent for the inpatient hospital services permissible class based on taxes that were enacted and imposed as of July 4, 2025, the State's threshold would be 4.7 percent for FFY 2027, 2028, and 2029.

Beginning in FFY 2030, the applicable percent would be 4.5 percent because this is the lower of

the July 4, 2025, threshold and the phased-down applicable percent for that year. In this example, the phased-down applicable percentages of 5.5 percent for FFY 2028 and 5 percent for FFY 2029 would not affect the State, because 4.7 percent is lower than each of those phased-down alternate thresholds. This phase down for expansion States is not applicable to health care-related taxes imposed on the nursing facility or intermediate care facility for individuals with intellectual disabilities (ICF/IID) permissible classes, although those permissible classes will still be held to the threshold calculated as of July 4, 2025.

Direct and Indirect Hold Harmless Arrangements

Section 1903(w)(4)(C)(i) of the Act provides that a hold harmless provision exists where "[t]he State or other unit of government imposing the tax provides (directly or indirectly) for any payment, offset, or waiver that guarantees to hold taxpayers harmless for any portion of the costs of the tax."

There are two general types of hold harmless arrangements: direct and indirect.

Under a direct hold harmless arrangement, the State provides a payment (Medicaid or non-Medicaid), offset, or waiver to the providers (whether through direct or indirect payments, including payments redistributed through an intermediary) that guarantees to repay the providers for part or all of the cost

of the tax and thereby holds them harmless for the cost of the tax. It is the payment, not necessarily the unit of government, that guarantees to hold the provider harmless for the cost of the tax.

Under an indirect hold harmless tax structure providers are held harmless for their tax costs based on the level of taxation. Historically, CMS used a mathematical indirect hold harmless test to identify such arrangements, with a threshold generally set at no more than 6 percent of net patient revenue attributable to the permissible class.

CMS Proposes to Add New Definitions to § 433.52

CMS proposes to add and define "Expansion State" to mean, as used in part 433, subpart B, a State that, beginning on January 1, 2014, or on any date thereafter, elects to provide medical assistance to all individuals described in section 1902(a)(10)(A)(i)(VIII) of the Act under the State plan or under a waiver of such plan.

CMS proposes to add and define "Net Patient Revenue" to "mean revenues received by the taxpayer, which are revenues attributable to the assessed permissible class of health care items or services, regardless of payer source."

CMS is proposing to expand the permissible class list to include a class for health insurers to provide States with clarity regarding the treatment of taxes on health insurers under section 1903(w) of the Act and to support consistent application of the statutory and regulatory requirements governing health care-related taxes. This change would facilitate CMS review of such taxes under the existing framework applicable to permissible classes, including whether such taxes are structured in a manner.

Calculation of Threshold

The requirements of section 71115 of the WFTC legislation are effective "for fiscal years beginning on or after October 1, 2026," and CMS proposes to calculate the thresholds based on a State Fiscal Year (SFY) of data. CMS proposes to apply the threshold for the purposes of monitoring and possible enforcement on a Federal fiscal year (FFY) basis.

In § 433.74(b)(3), CMS proposes that by June 30, 2028, each State must provide, in a form and manner to be determined by the Secretary, the actual net patient revenue and tax collection data for all health care-related taxes enacted and imposed as of July 4, 2025, along with any documentation and data necessary for CMS to calculate the final indirect hold harmless percentage for each permissible class. Specifically, CMS proposes that these data and documentation include by tax: the applicable permissible class; tax collection amount and the net patient revenue for all providers in the permissible class. During and after receipt of these submissions, CMS would verify the State's data and perform the calculations necessary to establish the final indirect hold harmless percentage for each permissible class.

After completing this review, CMS would notify the State of the final indirect hold harmless percentage for each permissible class, including any applicable phase down.

Regulatory Impact

CMS estimates provider taxes would result in $98.6 billion in revenue for States in calendar year 2026.

The following table shows estimated tax revenue by the most commonly utilized permissible provider classes for 2026.

Provider class	Provider tax revenue
Managed care organizations	$28.1
Hospitals (includes both inpatient and outpatient)	$61.8
Nursing facilities and intermediate care facilities	$7.3
All other classes	$1.4
Total	**$98.6**

CMS estimates two primary effects of the proposed rule on provider tax revenue collected by States.

The first effect is that there would be no new provider taxes following enactment of the legislation.

This freeze reduces projected tax revenue by $2.3 billion in 2026 and by $51.0 billion from 2026 through 2035.

The second effect is based on phasing down the indirect hold harmless threshold for provider taxes in expansion States beginning in FFY 2028. This change would further reduce provider tax revenue, with a projected decrease of $0.3 billion in 2026 and by $147.7 billion from 2026 through 2035.

CMS projects that when combined, the effects would reduce State provider tax revenue by about $198.7 billion over the next 10 years ($51.0 billion + $147.7 billion). (Page 90)

CMS estimates that this proposed rule would have no effect on enrollment and that all reductions in spending would be made through reductions in provider payments and benefits provided.

Comment

CMS projects that under this proposed rule, Federal Medicaid spending would be reduced by $245.8 billion and State Medicaid spending would be reduced by $138.2 billion over the next 10 years, for a total reduction of $384.0 billion. It is not clear how CMS arrives at these numbers.

Further, it is difficult to believe no enrollment reductions by providers.

Final Thoughts

For the most part, the elements in this proposal are easy to understand.

1. Currently regulations set the amount of provider taxes imposed by states cannot exceed 6.0 percent. If the tax exceeds the 6 percent threshold, CMS will evaluate the tax under the second prong of the test, referred to as the "75/75 test." This prong measures if, in the aggregate, 75 percent of taxpayers receive 75 percent or more of their total tax costs back in enhanced Medicaid payments or other State payments.

2. Section 71115(a) of the WFTC legislation replaces the "6 percent" threshold with an amount calculated generally based on the percent of net patient revenue attributable to the permissible class for which a health care-related tax was enacted by a State or unit of local government, and that State or locality imposes such tax as of July 4, 2025. If a State or unit of local government has not enacted and imposed such a tax for the permissible class as of July 4, 2025, the applicable percent for that class is zero percent.

3. Starting FFY 2028, the applicable threshold for each permissible class will be the lower of the July 4, 2025, calculated threshold, or the applicable percent for the FFY (5.5 percent in FFY 2028, decreasing by 0.5 percentage points annually until reaching 3.5 percent in FFY 2032).

A common observation dictates that any state with a current provider tax of 3.5 percent or less may not be impacted. Any state with provider taxes greater than 3.5 percent will incur payment reductions and the reductions over the next 10 years are significant.

The rule is somewhat difficult to follow. There is much repetition of material and some appear at odds with other citations.

Since hospitals are the largest recipients of provider taxes, they need to fully understand the proposal.