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

June 26, 2026

Mr. Tyler Sadwith
State Medicaid Director
State of California, Department of Health Care Services
1501 Capitol Avenue, 6th Floor, MS 0000
Sacramento, CA 95814-5005

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 Hospital Quality Assurance Fee Phase 9 on inpatient hospital services. Upon review and consideration of the information formally provided to the Centers for Medicare & Medicaid Services (CMS) on March 28, 2025, and revised on March 13, 2026, 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 the state requested a waiver would be imposed as follows:

i. Public hospitals are excluded from the tax;
ii. Small and rural hospitals are excluded from the tax;
iii. Psychiatric and specialty hospitals are excluded from the tax;
iv. New hospitals as defined in California Welfare and Institutions Code section 14169.51, subdivision (ai) are excluded from the tax;
v. Out-of-state hospitals are excluded from the tax;
vi. Non-Medi-Cal fee-for-service inpatient days will be assessed a fee of $527.35 per inpatient day for calendar year 2025;
vii. Non-Medi-Cal managed care inpatient days in hospitals owned by managed care organizations will be assessed a fee of $224.00 per inpatient day for calendar year 2025;
viii. Non-Medi-Cal managed care inpatient days in all other hospitals will be assessed a fee of $400.00 per inpatient day for calendar year 2025;
ix. Medi-Cal managed care inpatient days in hospitals owned by managed care organizations will be assessed a fee of $406.00 per inpatient day for calendar year 2025; and
x. Medi-Cal managed care inpatient days in all other hospitals and Medi-Cal fee-for-service inpatient days will be assessed a fee of $725.00 per inpatient day for calendar year 2025

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 tax structure is generally redistributive. The state's statistical demonstration is addressed below. Additionally, to be considered generally redistributive, the health care-related tax must also satisfy the requirements located at 42 § CFR 433.68(e)(3). Moreover, federal regulations at 42 § CFR 433.68(f) describe the circumstances in which a direct correlation would exist. Upon review of the state's statute implementing the proposed inpatient hospital services tax and the state's proposed methodology for increasing Medicaid reimbursement to hospitals, it appears that no direct correlation exists between the tax and any associated increases in Medicaid reimbursement.

Analysis

To determine the generally redistributive nature of the proposed inpatient hospital services patient day tax, the state calculated the slope (expressed as B1) of a linear regression for a broad-based and uniform tax in which the dependent variable was each hospital's percentage share of the total tax paid, if the tax was uniformly imposed on all hospitals' patient days in the state and the independent variable was each hospital's Medicaid patient days.

The state 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 hospital's percentage share of the total tax paid and the independent variable was the Medicaid patient days for each hospital.

Using the patient days and tax rate data you provided, CMS also performed the regression analysis calculations required in the regulations for the proposed tax. CMS finds that the result of the generally redistributive calculation for the state's inpatient hospital services tax is **1.05565**.

Section 71117 of the Working Families Tax Cut (WFTC) legislation (Public Law 119-21) amended the health care related tax provisions to address the use of statistical tests that could result in Medicaid utilizing providers bearing a lower relative tax burden than other providers. Recognizing that some existing state taxes would require modification to comply with the new requirements, Congress authorized a transition period for affected states to come into compliance. CMS informed California, in a letter dated April 3, 2026, that its inpatient hospital tax did not comply with section 1903 (w)(3)(E)(iii)(II) and 42 CFR § 433.68(e)(3)(i), and that California would have until June 30, 2028, to achieve compliance.

CMS recognizes that statements in the Dear Colleague Letter issued November 14, 2025,[1] the final rule preamble, and the April 3 letter could be interpreted to suggest that CMS would not approve health care-related tax waiver requests during the transition period unless they fully comply with section 71117. However, the purpose of the transition period is to facilitate an orderly transition to compliance. Accordingly, CMS may approve waiver amendments that advance compliance with section 71117 during the transition period, provided they satisfy all other applicable federal requirements. California's HQAF Phase 9 waiver amendment advances compliance by reducing the relative tax burden on Medicaid business compared to commercially reimbursed business. Nothing in this approval relieves California of its obligation to come into full compliance by June 30, 2028.

Given the state's efforts to come into compliance with section 71117 of the WFTC legislation, we are able to approve your request for a waiver of the broad-based and uniformity provisions of sections 1903(w)(3)(B) and (C) of the Act for the proposed inpatient hospital services patient day 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 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's initial request for a waiver of the broad-based and uniformity requirements on March 28, 2025, with a requested effective date of January 1, 2025. Therefore, the effective date of the state's request for a waiver of the broad-based and uniformity requirements is January 1, 2025. 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.

Please also note that in the November 14, 2025, Dear Colleague Letter, CMS provided preliminary guidance regarding the implementation of section 71115 of the WFTC legislation. In that letter, CMS outlined the circumstances under which revenues collected under a tax structure that was both enacted and imposed as of July 4, 2025, would be included in determining the applicable percent for purposes of the indirect hold harmless threshold, which will apply beginning October 1, 2026.

Effective October 1, 2026, any revenues from taxes imposed on permissible classes that exceed the indirect hold harmless threshold calculated in accordance with section 71115 of WFTC legislation may be disallowed from Medicaid expenditures, in accordance with section 1903(w)(1)(A)(ii) of the Act and 42 CFR § 433.70(b). We strongly encourage you to remain mindful of the requirements under section 71115 and to monitor future communications from CMS for updates or changes relevant to compliance with this provision.

[1] https://www.medicaid.gov/medicaid/downloads/providertax_dcl_11142025.pdf

We also remind California of the obligation to comply with all relevant statutory requirements including section 1903 (w)(4)(C)(i) of the Act. However, we reaffirm our intent that until January 1, 2028, CMS generally will not enforce sections 1903(w)(1)(A)(iii) and (w)(4) of the Act and 42 CFR § 433.68(b)(3) and (f) with respect to health care-related tax programs with hold harmless arrangements involving certain provider payment redistribution arrangements that existed as of April 22, 2024.

CMS reserves the right to perform a financial management review at any time to ensure that the state's operation of the tax on hospitals continues to meet the requirements of section 1903(w) of the Act. This may include a review of data that was not available during CMS's original review. CMS may deduct revenues from any health care-related tax found to be impermissible, in accordance with section 1903(w)(1)(A)(ii) of the Act and 42 CFR § 433.70(b).

If you have further questions or need additional information, please contact Jonathan Endelman at (410) 832-6063.

Sincerely,

Rory Howe
Director