The Managed Care Organization (MCO) Tax

Frequently Asked Questions on the Proposed 2024 Ballot Initiative

What is the MCO tax?

This tax has been in place in California for several years. While it has had several forms, the most recent iteration lapsed at the beginning of 2023 but has since been reauthorized under state law. Because the tax is used to leverage significant federal Medicaid funding, the state is required to obtain federal approval.

The tax applies to the (historical) monthly Medi-Cal and commercial enrollment of MCOs. By placing higher tax rates on MCOs' Medi-Cal enrollment — which is federally required to be built into Medi-Cal health plan capitation rates, as opposed to commercial enrollment — the tax raises substantial revenue without significantly negatively impacting the commercial premiums Californians pay.

What action did the state take in 2023 on the MCO tax?

In June 2023, the Legislature and governor reached an agreement on the 2023-24 budget that includes a commitment to use MCO tax revenues to begin to address longstanding shortfalls in Medi-Cal provider payments. Accordingly, the budget reauthorizes the MCO tax at much higher levels than previously and commits the majority of the resultant state revenues to improving Medi-Cal provider payments. Assembly Bill (AB) 119 reauthorizes the tax and establishes the tax structure and AB 118 establishes (at a high level) how the funding must be spent (specifically, see sections 139-141 of the bill language).

Pending federal approval (which we deem likely), the tax will be in place from April 2023 through the end of 2026. Over its lifespan, the tax will generate $19.4 billion in net revenues available for state purposes. While the MCO tax will be in place for nearly four years, the revenues are planned to be spent over six years, with most of the provider payment increases beginning in 2025. Annually, almost $2.7 billion in MCO tax revenues will support provider payment increases.

When including the federal Medicaid match funds (that will be sought for most of the provider payment increases), we expect hospitals to receive $1.7 billion annually beginning in 2025. In addition, we estimate that about $4.9 billion (state and federal funds) will support other provider payment increases, including for primary and specialty care, ground ambulance providers, family planning, behavioral health providers, and workforce. (These non-hospital payment increases may benefit hospitals and health systems as well.) More information on the budget action related to the MCO tax can be found in these FAQs.

What is the proposed MCO tax ballot initiative?

The Protect Access to Healthcare Act of 2024 is a proposed ballot measure that would:

- Permanently authorize the MCO tax in state law

- Dedicate the revenues to further address longstanding patient access and provider reimbursement shortfalls in the Medi-Cal program
- Prevent the revenues from being diverted to other purposes

By 2027, we expect the initiative to deliver between $4 billion and $5 billion annually in state funds for payment increases for Medi-Cal providers. Most of this state funding will be matched with federal Medicaid funding, resulting in total payment increases of more than $11 billion annually. We generally expect the funding to support reimbursement increases based on the utilization and intensity of services rendered to Medi-Cal patients.

The Initiative specifies in percentage terms how much funding will support different service categories. In dollar terms, beginning in 2027, we expect the following service categories to receive total annual payment increases in the following amounts:

- Hospital and emergency department services: between $2 billion and $3 billion
- Primary care: over $3 billion
- Specialty care: around $3 billion
- Family planning: over $1 billion
- Other services: nearly $1.5 billion

If it qualifies, the measure will be on the November 2024 ballot. A broad coalition of health care providers and payers are backing the initiative, including hospitals, doctors, health care workers, health centers, family planning providers, health plans, and first responders.

What are the differences between what was approved in the state budget and the ballot initiative?

The goal of the ballot initiative is to build on and protect the progress made through the 2023 budget. Accordingly, the initiative makes no changes to the underlying structure of the MCO tax and funds the categories of services that will receive funding through the budget action (with a number of key additions, described below). Finally, it preserves the use of roughly $8 billion in MCO tax revenues to address the state budget deficit.

However, there are a number of key differences between the MCO tax ballot initiative and budget action:

- **Permanent Authorization.** While state authorization of the MCO tax is set to expire at the end of 2026 — necessitating the passage of new state legislation to reauthorize it — the ballot initiative would permanently reauthorize the tax under state law. Federal approval of the MCO tax structure will have to be periodically renewed. (Furthermore, any provider payment methodologies that draw down federal matching funds must obtain separate federal approval.) The ballot initiative would require the Department of Health Care Services (DHCS) to seek federal approval of the MCO tax each time federal approval expires, which we expect will occur every three years. While the provider payment increases pursuant to the budget agreement are intended to be ongoing, the potential loss of the supporting revenues after 2026 places them at risk. Accordingly, the

permanent state law authorization of the MCO tax provides greater assurance that the funding will be there to support the improved payments on an ongoing basis.

- **Assured Funding Shares.** While the budget-related legislation implementing the MCO tax requires DHCS to implement provider payment increases in the various service categories previously described, it does not specify how much funding should go to each category. (Instead, DHCS specified the funding shares in a non-binding fact sheet.) The ballot initiative would ensure equitable funding shares among the different categories of services by specifying the percentage of MCO tax going to each.
- **Additional Service Categories.** The ballot initiative would ensure that additional service provider categories are able to share in the funding from the MCO tax. In addition to those that will benefit from the budget action, the ballot guarantees support for inpatient psychiatric services, clinics, dental care, affordable drugs, and community health workers.
- **More Annual Funding for Provider Payment Increases.** Under the budget action, the state will spend the MCO tax funding dedicated to provider payment increases over six years instead of over the nearly four years the MCO tax will be in effect. In contrast, under the ballot initiative, the revenues will be spent annually as they come in. Additionally, under the budget plan, roughly $2 billion in MCO tax revenues will help the state address its budget deficit annually from 2023 through 2026. Starting in 2027, this portion would be reduced to 50% of any MCO tax revenues that exceed $4.5 billion. As a result of both changes, we expect that over $4 billion in MCO tax revenues will support improved provider payments annually, up from around $2.7 annually under the budget agreement.
- **Robust Stakeholder Consultation.** Under the budget agreement, the specific methodologies for improving provider payments will be developed and authorized via the annual budget process (generally starting with the budget process that commences next year). Accordingly, stakeholders will have the opportunity to provide input into the development of the payment methodologies primarily through the budget process. The ballot initiative, in contrast, establishes a more robust and dedicated process for stakeholder input. Specifically, the initiative requires the state to consult with and obtain input in the development and implementation of the required provider payment increases from a stakeholder advisory committee established for this purpose. Members of the committee will be appointed by the governor and Legislature and be representative of the providers and payers of the services that will be funded by the MCO tax.

When will the ballot initiative take effect?

The ballot initiative would generally take effect in January 2025 if voter approval is secured on the November 2024 ballot. However, certain components of the initiative will be implemented at different times due to the interaction between the initiative and actions taken in the 2023 budget.

- Beginning in 2025, the annual revenues from the MCO tax authorized in the 2023 budget will be deposited in the Protect Access to Health Care Fund established by the ballot initiative.
- For 2025 and 2026, the state may use up to $2 billion annually in MCO tax revenues to support the General Fund and address the state budget deficit. Beginning in 2027, the

amount that can be used for this purpose is limited to 50% of MCO tax revenues that exceed $4.5 billion.
- Beginning in 2026, the provider payment increases implemented by DHCS must be in accordance with the requirements of the initiative.
- For 2027 and every approximately three years thereafter, DHCS will have to request federal approval of a new MCO tax consistent with the requirements of the initiative.

How much funding will my hospital receive under the ballot initiative?

As is the case under the MCO tax budget agreement, since the ballot initiative does not prescribe which detailed payment methodologies are to be used, it is impossible at this time to determine how reimbursement levels would increase for any individual hospital. Such details would be developed by DHCS after the initiative is approved and with the input of the stakeholder advisory committee mentioned above. For example, it is currently unknown which outpatient procedures would be targeted for payment increases. Determining the full impact for individual hospitals is even harder given that different hospitals will benefit from different funding categories. For example, hospitals with certain relationships with billing practitioners (such as those that employ physicians) would directly benefit from the primary and specialty care payment increases. Additionally, hospitals that successfully obtain GME funding for the new residency slots they open would receive higher amounts of funding that cannot be projected at this time.

How will potential changes to federal rules affect the MCO tax going forward?

The Centers for Medicare & Medicaid Services, most recently under the Trump administration, has attempted to change federal regulations to limit the scope and use of permissible health care-related taxes like the MCO tax to finance the nonfederal share of Medicaid payments. So far, such attempts have been unsuccessful. However, future attempts to change these rules could succeed. Depending on the details of potential changes to federal rules on health care-related taxes, modifications to the structure of the MCO tax could be needed to meet federal approval. (The ballot initiative affords DHCS with flexibility to obtain or maintain federal approval of the tax up to specified limits.) In the worst case, these federal changes could have the effect of limiting the amount of available revenues or making it effectively infeasible to continue to implement the tax. Whether policymakers would be successful in making such changes to federal rules where they previously have not, including the ability to withstand legal and/or congressional actions, is ultimately highly uncertain.

What is CHA's role in the ballot initiative?

CHA was a founding member of the Coalition to Protect Access to Care, which was formed to rethink how the state's MCO tax revenues are used, ensure they remain in the health care system, and are dedicated to the betterment of patient care. CHA worked closely with its coalition partners, including the California Medical Association, trade associations representing health plans, Planned Parenthood, Service Employees International Union, and others to carefully craft the initiative language and ensure the dollars go to where they are needed.