



Michelle Baass, Director & Interim State Medicaid Director
Department of Health Care Services
1501 Capitol Ave
MS 0000
Sacramento, CA 95899-7413

Dear Director Baass:

This is in response to your request for a waiver of the broad-based and uniformity requirements related to a health care-related tax program on inpatient hospital services. California is requesting this waiver as an update to its previously approved waiver of the broad-based and uniformity requirements for the Hospital Quality Assurance Fee (HQAF) for its inpatient hospital assessment program. Upon review and consideration of the information formally provided to the Centers for Medicare & Medicaid Services (CMS) on March 22, 2023, and subsequently revised on June 30, 2023, July 24, 2023, September 19, 2023, and November 20, 2023, 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 California 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 \$364.94 per inpatient day for calendar year 2023 and \$432.79 per inpatient day for calendar year 2024;
- (vii) Non-Medi-Cal managed care inpatient days in hospitals owned by managed care organizations will be assessed a fee of \$204.34 per inpatient day for calendar year 2023 and \$243.04 per inpatient day for calendar year 2024;
- (viii) Non-Medi-Cal managed care inpatient days in all other hospitals will be assessed a fee of \$364.89 per inpatient day for calendar year 2023 and \$434.00 per inpatient day for calendar year 2024;
- (ix) Medi-Cal managed care inpatient days in hospitals owned by managed care organizations will be assessed a fee of \$347.20 per inpatient day for calendar year 2023 and \$408.80 per inpatient day for calendar year 2024; 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 \$620.00 per inpatient day for calendar year 2023 and \$730.00 per inpatient day for calendar year 2024.

Section 1903(w)(3)(E) of the Act specifies that the Secretary shall approve uniformity (and broad-based) waiver applications if the net impact of the tax is generally redistributive and that 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 structure is generally redistributive. California's statistical demonstration is addressed below. Moreover, federal regulations at 42 CFR § 433.68(f) describe the circumstances in which a direct correlation would exist. Upon review of the California statute implementing the proposed hospital tax and California'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.

To determine the generally redistributive nature of the proposed inpatient hospital patient day tax, California 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 hospital inpatient days in the state and the independent variable was each hospital's number of Medicaid inpatient days. California 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 number of Medicaid patient days for each hospital.

Using the patient day 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 California inpatient hospital patient day tax is **1.00568** for calendar year 2023 and **1.00761** for calendar year 2024.

Therefore, we are able to approve your request to modify your waiver of the broad-based and uniformity provisions of sections 1903(w)(3)(B) and (C) of the Act for the proposed inpatient hospital 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 of California 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 of California's initial request for a waiver of the broad-based and uniformity requirements on March 22, 2023, with a requested effective date of January 1, 2023. Therefore, the effective date of California's request for a waiver of the broad-based and uniformity requirements is January 1, 2023. 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.

CMS is also providing a companion letter to this tax waiver approval letter. 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. CMS reserves the right to perform a financial management review at any time to ensure that the state operation of the tax on hospitals continues to meet the requirements of section 1903(w) of the Act.

I hope this information addresses all of your concerns. If you have further questions or need additional information, please contact Jonathan Endelman at (410) 786-4738.

Sincerely,

Rory Howe
Director
Financial Management Group



Michelle Baass, Director & Interim State Medicaid Director
Department of Health Care Services
1501 Capitol Ave
MS 0000
Sacramento, CA 95899-7413

RE: California Hospital Quality Assurance Fee Tax Waiver Approval

Dear Director Baass:

This letter is being sent as a companion to our approval of California's request for a waiver of the broad-based and uniformity requirements under section 1903(w)(3)(B) and (C) of the Social Security Act (the Act) for the state's Hospital Quality Assurance Fee on inpatient hospital services.

During our review of California's waiver request, the Centers for Medicare & Medicaid Services (CMS) determined that the state's tax would impose a much higher tax burden on Medicaid inpatient hospital days compared to non-Medicaid inpatient hospital days. Specifically, for calendar year 2023, Medicaid inpatient days comprise about 32% of all inpatient days but experience over 44% of the total tax burden. Section 1903(w)(3)(E) of the Act provides, as relevant here, that the Secretary shall approve a health care-related tax waiver for the broad-based and/or uniformity requirements if the net impact of the tax and associated Medicaid expenditures is "generally redistributive in nature." Implementing regulations in 42 C.F.R. § 433.72(b) require that, "for CMS to approve a waiver request . . . the State must demonstrate, to CMS's satisfaction," that "[t]he net impact of the tax and any payments made to the provider by the State under the Medicaid program is generally redistributive, as described in § 433.68(e)[.]" In turn, 42 C.F.R. § 433.68(e) specifies two statistical tests for determining whether a given tax waiver request would result in a tax program that is "generally redistributive," with the applicable test depending on whether the state is requesting a waiver of the broad-based requirement only or is requesting a waiver of the uniformity requirement (whether or not the state also is seeking a waiver of the broad-based requirement). Because California requested a waiver of the broad-based and uniformity requirements, the applicable statistical test is specified in 42 C.F.R. § 433.68(e)(2) and is referred to as the "B1/B2 test."

CMS, then known as the Health Care Financing Administration, implemented the statistical test approach in a 1992 interim final rule with comment period, 57 *Fed. Reg.* 55118 (Nov. 24, 1992) (1992 IFC). In preamble to the 1992 IFC, we explained that we intended this approach "to balance our desire to give states some degree of flexibility in designing tax programs with our need to preclude use of revenue derived from taxes imposed primarily on Medicaid providers and activities." *Id.* at 55128. "For purposes of these regulations," we explained, "we have interpreted the term 'redistributive', as used in the statute, to mean the tendency of a state's tax and payment program to derive revenues from taxes imposed on non-Medicaid services in a class of items or services (or providers of these services), and to use these revenues as the state's share of Medicaid payments. To the extent that a tax is imposed more heavily on providers with low Medicaid utilization than high Medicaid providers, the tax would be considered redistributive." *Id.*

We finalized the statistical tests in a 1993 final rule, 58 *Fed. Reg.* 43156 (Aug. 13, 1993). In the preamble to the final rule, we confirmed the interpretation of the concept of “generally redistributive” described in the 1992 IFC. Specifically, we stated that “our definition of ‘generally redistributive’ is the tendency of a state's tax and payment program to derive revenues from taxes imposed on non-Medicaid services in a class and to use these revenues as the state's share of Medicaid payments.” *Id.* at 43164.

California’s tax on inpatient hospital services, due to its tendency to derive revenues from Medicaid, does not appear consistent with the definition of “generally redistributive” as defined in the preambles to the 1992 IFC and the August 1993 final rule. California’s tax derives revenues mainly from Medicaid services (instead of non-Medicaid services) and uses these revenues as the state’s share of Medicaid payments. Accordingly, we are concerned that this tax program fails to be “generally redistributive in nature.” However, CMS is approving California’s request for a waiver of the broad-based and uniformity requirements because the state’s proposal meets the applicable statistical test specified in 42 C.F.R. § 433.68(e)(2), with a B1/B2 value of at least 1. As specified in 42 C.F.R. § 433.68(e)(2)(ii), where the state demonstrates to the Secretary’s satisfaction that the value of B1/B2 is at least 1, “CMS will automatically approve the waiver request.”

The result of the statistical test, in this instance, does not appear consistent with either the definition of generally redistributive or reflective of the expected results based on the intended design of the statistical test. Therefore, CMS intends to develop and propose new regulatory requirements through the notice-and-comment rulemaking process to address this issue. As with any notice-and-comment rulemaking process, the public at large, including the State of California, would have the opportunity to provide any comments or input on any proposed changes to current regulations. Please be advised that any future changes to the federal requirements concerning health care-related taxes may require the state of California to come into compliance by modifying its tax structure.

I hope this information addresses all of your concerns, if you have further questions or need additional information please contact Jonathan Endelman at (410) 786-4738.

Sincerely,

Rory Howe
Director
Financial Management Group