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ISSUE BRIEF

Proposed Changes to Provider Taxes

July 2026 Proposed Rule

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INTRODUCTION

The Amending the Indirect Hold Harmless Threshold of Health Care-Related Taxes Proposed Rule, which the Centers for Medicare & Medicaid Services (CMS) published on July 23, 2026, outlines changes to provider taxes. These amendments respond to directives in the budget reconciliation legislation enacted July 4, 2025, P.L. 119-21, now known as the Working Families Tax Cut Act (WFTCA).

The proposed changes are intricate and will require attention to detailed timelines and precise methodologies. Health Management Associates, Inc. (HMA), experts have devoted significant time to reviewing and analyzing the regulation and are available to assist organizations in understanding its requirements, assessing potential impacts, and considering strategic next steps. To support your evaluation of the proposed rule and its potential implications, they have prepared the following summary of the key provisions. The complete proposed rule can be found **here**.

Overview

As enacted, the WFTCA prohibits the establishment of new provider taxes and limits the growth of provider taxes now in place. Specifically, Section 71115 of the WFTCA lowers the provider tax hold harmless threshold for any new provider taxes established on or after October 1, 2026, from the current 6% limit to 0%. Existing provider taxes are grandfathered and may continue under separate transition rules.

Specifically, all taxes on nursing facilities and intermediate care facilities for individuals with intellectual disabilities (ICF/IIDs), as well as all provider taxes in non-expansion states, may continue at their current grandfathered hold harmless threshold. For grandfathered taxes in expansion states, the legislation establishes a phase-down period beginning in federal fiscal year (FFY) 2028, with the applicable hold harmless threshold reduced by 0.5% annually until reaching 3.5% in FFY 2032. Expansion state taxes are limited by the lesser of their grandfathered threshold and the applicable hold harmless threshold in each year.

CMS proposed additional changes to the hold harmless determination to remove the provision that allows states to exceed the threshold if a certain proportion of taxpayers see no net benefit from the program. They also defined a new permissible class of providers for taxing purposes.

Proposed Rule Changes Discussed in this Issue Brief

1. Revising the interpretation of the **enacted** and **imposed** language from initial published guidance to determine which taxes meet the grandfathering requirements
2. Defining the methodology and process that will be used to determine the grandfathered tax rate thresholds for existing provider taxes
3. Instituting new one-time and ongoing reporting requirements to states related to the scale, application, and uses of provider taxes by provider class
4. Removing the second prong of the two-prong indirect hold harmless test that allows states to exceed the hold harmless threshold if no more than 75% of taxpayers receive 75% or more of their taxes back in tax-funded benefits
5. Establishing a new permissible tax class on other health insurers that do not fit under the existing class definition of managed care organizations

INTERPRETATION OF ENACTED AND IMPOSED

The WFTC legislation states that any tax on providers that a state or local unit of government has **enacted** and **imposed** as of July 4, 2025, will be eligible for grandfathering. In a "Dear Colleague" letter released on November 14, 2025, CMS provided its initial interpretation of this legislation.

Specifically, CMS noted that meeting the definition of **enacted** would require two components: 1) a completed legislative process, and 2) an approved broad-based or uniformity tax waiver, if required, as of July 4, 2025.

A tax would be defined as **imposed** if the state or local government were actively collecting revenue or had the authority to collect it on a delayed schedule, as of July 4, 2025.

Summary of Proposed Rule

In the proposed rule, CMS has revised its interpretation and calls for moving the status of the tax waiver into the imposed definition and allows for delayed approvals, as long as they are approved retroactive to a date prior to July 4, 2025.

Key Components

- **Enacted definition:** The proposed definition includes any tax that has completed the legislative process necessary to authorize the specific structure that was in effect on July 4, 2025.
    - This provision excludes any legislative changes passed after July 4, 2025, which were retroactive back to July 4, 2025, or earlier.
- **Imposed definition:** The proposed definition includes two parts:
    - The state or local unit of government must have had the authority to begin collecting the tax as of July 4, 2025.
    - If a waiver of the broad-based or uniformity requirements were necessary to implement the tax, the state or local unit of government must have received the waiver approval with an effective date on or before July 4, 2025. The waiver did not need to be approved by July 4, 2025.

Key Implications and Potential Concerns

- Because the hold harmless tax rate threshold was moved to 0% beginning October 1, 2026, some states may have enacted and implemented provider taxes that will be ineligible for grandfathering.
    - Any new tax enacted or imposed after July 4, 2025, will need to sunset before October 1, 2026.
    - Any existing tax that had an enacted or imposed increase after July 4, 2025, will be grandfathered at the pre-increase level.
- Some states may have passed new or increased provider taxes during their 2025 legislative sessions with an effective date past July 4, 2025, to align with the current tax schedule, the state fiscal year, or with the planned spending of tax funds—a common practice, as states need the authority to levy or increase taxes before they can take effect. The imposed criteria as proposed, however, would disqualify these taxes from grandfathering.
- If the state or local government failed to collect the full tax amount prior to July 4, 2025, it will need to provide documentation showing that the taxpayers were subject to a legally enforceable obligation to pay the tax by July 4, 2025. Documentation may include billing information or collection activity. CMS also offers to provide assistance in determining what constitutes appropriate documentation.

- Allowing for tax waivers approved after July 4, 2025, to qualify for grandfathering is more aligned with the historical process for establishing new taxes or tax structures. Federal regulations allow tax waivers to be retroactive to the beginning of the quarter in which they were submitted to CMS for approval, establishing a precedent for preserving an effective date regardless of the time it takes CMS to review and approve a tax waiver application.

DEFINING THE GRANDFATHERED TAX RATE THRESHOLD

Under the WFTC legislation, provider taxes that qualify for grandfathering will be limited to the lesser of their grandfathered tax rate threshold and the applicable phase-down hold harmless threshold for the applicable period (the phase down does not apply to non-expansion states or to any tax on nursing facilities or ICF/IID providers so their thresholds will continue to be their grandfathered rates). The grandfathered tax rate threshold is equal to the tax collection as a percentage of net patient revenue for the taxed class of providers.

Hold harmless thresholds by year for the taxes that must phase down as shown in **Table 1**.

Table 1. Timeline to Phase Down Hold Harmless Thresholds

Fiscal Year	Hold Harmless Threshold
2028	5.5%
2029	5.0%
2030	4.5%
2031	4.0%
2032 and Beyond	3.5%

Summary of Proposed Rule

To determine the grandfathered tax rate threshold for a tax on a class of providers, states will need to use actual data for the SFY that overlaps July 4, 2025. Because these data may not yet be available, CMS is calling for an interim calculation using the best data available, with an anticipated due date of the December 31, 2026, CMS-64 submission. A final calculation will then be completed with actual data for the time period and with a June 30, 2028, deadline.

Key Components

- **Data for threshold calculation:** The threshold will ultimately be calculated using the actual tax collection and net patient revenue data for the state fiscal year that overlaps July 4, 2025. For the final calculation, no projections or other data assumptions will be accepted. CMS will work with states to ensure the data are validated and includes all existing provider taxes and collection amounts for each provider class. Each provider class will have a threshold rate using tax and revenue data from their class alone.
- **Threshold numerator:** The numerator in the threshold calculation will include actual tax collections only. It will be exclusive of any unpaid tax liabilities.
- **Threshold denominator:** The denominator in the threshold calculation will include net patient revenue for all providers in the class, including non-taxpayers. It would exclude patient revenues owed but not collected.
- **Rounding of threshold:** CMS will round to nine decimal points when calculating the new thresholds. In future years, compliance against the threshold will also be determined based on the nine decimal places.
- **The 75/75 test threshold calculation:** If, as of July 4, 2025, a provider tax rate on a class was above 6%, but the tax also passed the 75/75 test, the full tax collection would be considered in the threshold calculation. The tax would still need to phase down consistent with the hold harmless thresholds outlined in the WFTCA. CMS anticipates that no tax would meet these criteria.
- **Preserved threshold:** If a state moved to lower its tax after July 4, 2025, to a rate below the established threshold, the state could retain the ability to increase future tax revenue collections up to the applicable limit.
- **Enforcement of thresholds:** Although CMS plans to calculate the threshold limits based on state fiscal year periods, they interpret the tax phase-down rates to apply on a FFY basis, so CMS will verify compliance by applying the applicable threshold for each FFY to the total tax collections and net patient revenue attributable to that class of providers and FFY. Once the transition to the grandfathered phase down and any applicable phase downs are complete, states can return to reporting based on state fiscal year.
- **Remediation:** If a state is found to be out of compliance and has collected an amount exceeding their allowable threshold, CMS will require a refund of the excess taxes. This refund must be paid back as a uniform rate across all taxpayers so that they all receive the refund in proportion to the tax they paid.
- **Penalties for exceeding threshold:** CMS notes that in general, they do not intend to apply penalties or take other enforcement actions if a state exceeds their tax threshold beyond requiring the overage to be refunded. If a state is suspected of having intentionally over collected, CMS will consider taking more punitive action.

- **Publication of final thresholds:** CMS intends to publicly publish each state and provider classes' final threshold by September 30, 2028.
- **New Expansion states:** If a state chooses to implement Medicaid expansion in the future, the phase-down thresholds would apply for the FFY in which the expansion becomes effective.
- **Waiver requests submitted before final thresholds established:** Because of the data lag in establishing the final thresholds, CMS plans to continue reviewing and approving new tax waiver requests based on the interim calculations. If necessary, states will need to make collection adjustments later based on the final thresholds.

Key Implications and Potential Concerns

- If a state is found to exceed the applicable threshold at any point and does not take the proper actions to remediate the overpayment, the entire tax on that class would be deemed impermissible for federal matching—not just the amount over the threshold—and CMS will deduct all taxes on that class from the state's claimed medical assistance expenditures.
- It is the state's responsibility to provide CMS with accurate and complete information to calculate the threshold amounts. If the state fails to do so, a state's final threshold could be understated and locked in at that rate.
- CMS proposes that the information needed to complete the interim calculation be submitted by December 31, 2026, in the form and manner CMS specifies. CMS has yet to publish a template to ensure states are uniformly reporting this information.
- With the remediation period occurring after the tax has already been collected and used to draw down federal Medicaid matching funds, it will be up to the state to develop a process for what happens in the case of an overcollection. Thus, the state may be required to claw back payments funded through the excess tax funds, reduce future Medicaid payments, or withhold tax dollars in a fund reserved for potential paybacks.
- CMS notes that if a state lowers the tax rate for a period of time, the state could still increase the tax back up to the applicable threshold; however, the examples in the proposed rule only discuss states lowering, not sunsetting, the tax. The lack of explicit confirmation that a state could stop taxing a class of providers entirely for a period of time and still retain the authority to tax that class up to the threshold could allow for varied interpretations in the future.
- Monitoring compliance with the applicable thresholds on a FFY basis rather than aligning with a state fiscal year could lead to complications. States may be unable to establish the authority to adjust tax rates mid-fiscal year. CMS requests comments on the best approach to operationalize this measurement of compliance.

- CMS cites hospital cost reports as a potential source of the net patient revenue data for the threshold calculation; however, hospitals submit those reports based on their varied fiscal years. It is unclear whether CMS will allow states to prorate those reports or if they will require supplemental reporting to track net patient revenue on a quarterly basis.
- CMS explicitly explains how a conversion from a non-expansion state to an expansion state will be treated under the proposal, but they do not address the reverse. It is unclear whether, in the event of a state ending expansion, their hold harmless threshold would move from the phased down amounts to the final threshold rate.

REPORTING REQUIREMENTS AND TIMELINES

CMS currently has few consistent reporting requirements related to provider taxes and their uses. When states request a waiver of the broad-based or uniformity requirements, CMS receives a comprehensive workbook outlining the tax structure, tax amounts paid, and Medicaid statistics by provider. When states implement broad-based and uniform taxes, they can do so without receiving explicit approval from CMS, giving CMS less visibility into these programs.

Summary of Proposed Rule

As mentioned above, CMS will require states to complete **one-time** reporting for every provider tax class on which a tax was considered enacted and imposed as of July 4, 2025. This reporting will technically be done twice—once for the interim calculation and once for the final.

For the **interim calculation**, states may determine the best available data and the methodologies, if any, used to extrapolate or trend forward to approximate the state fiscal year encompassing July 4, 2025. Along with the net patient revenue and tax collection data, states will also need to provide:

- The authorizing legislation for all relevant taxes
- Any related state regulation or administrative issuance required to implement the tax under the legislation
- If applicable, the approved waiver documentation that shows an effective date on or before July 4, 2025
- Information regarding what the taxes fund, including specific Medicaid payments supported by the tax

For the **final calculation,** states must provide actual net patient revenue and tax collection data for the state fiscal year encompassing July 4, 2025. The data cannot include any trend factors or completion adjustments. CMS plans to publish the final thresholds by September 30, 2028 (see **Table 2**).

Table 2. Timeline to Achieve Reporting Milestones

Event	Data Used	Anticipated Timing
Interim tax threshold calculation reporting	Data applicable to the SFY that contains July 4, 2025, using the best data available at the time of submission	Submit with the CMS-64 for the quarter ending December 31, 2026
Final tax threshold calculation reporting	Data applicable to the SFY that contains July 4, 2025, using actual data with no adjustments/trending	Reporting by June 30, 2028
Announcement of final threshold	Actual data submitted by June 30, 2028, for SFY that contains July 4, 2025	September 30, 2028 (to be posted publicly)

In addition to the one-time reporting for the interim and final grandfathered threshold calculations, starting October 1, 2026, states will be required to report the following on an **ongoing quarterly basis** for all provider taxes:

- Total tax revenue collections by tax and permissible class in its entirety
- Net patient revenue by permissible class
- What the tax is used to fund
- Whether the state has exempted any providers that are units of government in the reporting quarter
- Any additional information that Secretary of Health and Human Services has requested related to any health care-related taxes imposed on health care providers.

CMS will also require that for every FFY, the state reports actual tax collection and actual net patient revenue to determine compliance with the applicable tax thresholds.

Key Components

- CMS will require that states submit within two years all required data to determine compliance with the tax limit for the relevant FFY, including reporting net patient revenue derived from cost reports or other uniform sources. CMS anticipates that states will use this two-year period to return collections that exceed the applicable threshold in proportion to their tax paid.
    - States must be prepared to identify the source of any reported data if asked by CMS.
- Tax collections will be reported based on the taxing year they apply to, not when they were actually received by the state.
- Because public providers can be excluded from taxes without necessarily requiring a waiver of the broad-based or uniformity requirements, CMS will require that states begin to notify them in the first quarter the exclusion is effective.

Key Implications and Potential Concerns

- Although CMS notes that the agency generally does not intend to apply penalties to over collected taxes as long as they are remediated, it retains discretion to apply penalties and take enforcement action back to October 1, 2026. CMS warns that the two-year remediation period is not meant to effectively enable interest-free loans due to initial overcollection.
- It is unclear whether CMS expects states to collect new net patient revenue data from providers quarterly for both the quarterly and one-time interim/final reporting, or if states can provide estimates based on prorating cost reports or other data sources.
    - Under the disproportionate share hospital (DSH) audits, hospital cost reports are prorated to align with the standard fiscal year which may be a precedent to point to rather than increasing provider reporting.
    - The net patient revenue numbers reported quarterly will never align with actual data from that period because states will be required to submit it before the quarter ends. Although quarterly interim data alone are unlikely to trigger a requirement for states to refund amounts exceeding the threshold, CMS may rely on this information as evidence of intentional overcollection when determining whether a penalty is appropriate (see **Table 3**).

Table 3. Timeline to Achieve Enforcement

Event	Data Used	Anticipated Timing
Ongoing reporting of tax level compared with final threshold/hold harmless level	Data applicable to the respective quarters of the relevant FFY, using actual data	Quarterly, with enhanced reporting beginning October 1, 2026
Interim period—monitoring and waiver submissions	Interim threshold and phase-down thresholds	October 1, 2026-September 30, 2028
Compliance and remediation	Final threshold and phase-down thresholds	Ongoing, for the time between the end of a reporting period and possible enforcement
Enforcement of limits and, when necessary, federal Medicaid claiming reductions	Applicable FFY of ongoing reporting data and data about any remediation undertaken for the FFY	2 years following the end of the applicable reporting period

REMOVAL OF THE 75/75 TEST INDIRECT HOLD HARMLESS PROVISION

Under current regulations, all provider taxes must meet the hold harmless provisions. These provisions cannot be waived. They include an evaluation of a direct and an indirect hold harmless relationship.

A provider tax violates the hold harmless prohibition directly if taxpayers are effectively guaranteed reimbursement for the tax they pay. This occurs when:

- Providers receive payments tied to the amount of tax paid or to the gap between Medicaid payments and the tax.
- Medicaid payments vary solely based on the provider's tax contribution.
- The state provides payments, offsets, waivers, or other arrangements that directly or indirectly compensate providers for the tax.

For indirect guarantees, CMS currently applies a two-prong test:

1. Taxes are generally permissible if they raise no more than 6% of a provider's net patient revenue.
2. If tax collections exceed that threshold, CMS presumes a hold harmless arrangement exists when 75% or more of providers receive back at least 75% of their tax costs through enhanced Medicaid or other state payments.

Summary of Proposed Rule

CMS proposes to remove the second prong of the two-prong indirect hold harmless test. Essentially, this revision would mean that any tax above the applicable threshold would be deemed impermissible beginning October 1, 2026.

Key Components

- CMS plans to remove the second condition from the two-prong test, leaving only the first condition, which limits any provider tax to the applicable threshold (e.g., grandfathered, phase-down, or, in cases of new taxes, 0%).
- As previously noted, taxes in place on July 4, 2025, which relied on this provision and would otherwise qualify for grandfathering, would have their initial and final threshold set at the 2025 tax level above 6%. They would still be held to the same phase-down rate and timeline as all other grandfathered taxes.

Key Implications and Potential Concerns

- CMS believes states will have a greater incentive to rely on the second prong of the indirect hold harmless test as the indirect hold harmless threshold is lowered. Striking out this component is being done to preemptively stop states from considering this strategy.
- CMS cites the lack of usage of this 75/75 test as evidence that it is unnecessary and states do not rely on it today.

ESTABLISHING A NEW PERMISSIBLE TAX CLASS FOR "OTHER INSURERS"

Current regulations list 18 categories that are defined as a "separate class of health care items or services" and are considered distinct in terms of applying a healthcare-related tax to the respective class of services. The eighth item in this list is for "services of managed care organizations (MCOs) (including health maintenance organizations, preferred provider organizations)." This definition has allowed states to develop MCO taxes that are subject to the requirements of healthcare-related tax regulations, including broad-based and uniformity requirements (unless waived) and hold harmless provisions (which cannot be waived).

Summary of Proposed Rule

CMS proposes to add a 19th category to the list of distinct healthcare services: "Services of health insurers (other than services of managed care organizations (health maintenance organizations, preferred provider organizations))."

Key Components

- CMS asserts the need to define this class due to states placing taxes on health insurers that they would consider impermissible without this new definition, and that these "taxes on health insurers are not presently subject to the same class-specific review process applicable to recognized permissible classes."
- Any existing regulations, and any other provision finalized with this rule, would then apply to the proposed class. For example, if a state did not have a tax enacted and imposed for this class as of July 4, 2025, then that state would be unable to implement one in the future due to the threshold being set at 0%.
- CMS asserts that a "healthcare-related tax on this class could include, but need not be limited to, an assessment on health insurance premium revenue or covered lives."
- CMS proposes to defer to the state and state law in determining which entities should be included in the proposed class. Examples provided include plans that issue policies for the group and individual market, short-term limited-duration policies, insurers that offer plans to Medicaid beneficiaries under 1115 waivers that provide premium assistance to individuals purchasing qualified health plan coverage through the Health Insurance Exchange, and those that cover "excepted benefits" for the group market, such as dental-only and vision-only policies.

Key Implications and Potential Concerns

- While CMS asserts that this new class can be clearly defined due to states already having a specified universe of health insurers that they regulate, it will likely create confusion as to whether current taxes on types of insurers would fall under this class or if a future tax is permissible.
- States could no longer implement new taxes related to health insurers that previously would have been outside the purview of CMS, including tax funds that are used for administration of Marketplace platforms or insurance affordability programs and not used as the non-federal share for Medicaid payments.
    - If a state were to implement a state-based exchange rather than utilizing the federal Marketplace, it is unclear whether CMS would allow states to continue levying the same level of administrative fees.

- If it is determined that a state has an enacted and imposed tax on July 4, 2025, for a subset of health insurers, the state may need to collect a substantial amount of additional data to determine whether it meets future compliance requirements and for ongoing quarterly reporting.
    - For example, if a state imposed a tax that was limited to dental insurers, the proposed rule implies that the state would also need to collect revenue data from vision plans, home and community-based services plans, and any other non-MCO health insurer in the state to determine the grandfathering threshold and whether the tax meets the waiver requirements for being broad-based and uniform.
- CMS indicates that without this new class definition, the agency would consider certain existing state taxes to be impermissible. It is unclear whether CMS would force states to terminate those taxes if this provision is removed from the final rule.
- The full impact of this provision is unknown as the class definition and full scope of the intent is somewhat unclear.
    - CMS notes that "… taxes on health insurers are not presently subject to the same class-specific review process applicable to recognized permissible classes, making it more difficult for CMS to evaluate their structure and impact on Medicaid in a thorough and consistent manner." This language implies that the intent of this action is to better regulate the source of Medicaid financing, but as proposed, it could have much broader implications and interactions with taxes that have no link to the Medicaid budget.

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