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ISSUE BRIEF

CMS Proposed Indirect Hold Harmless Rule Would Affect Medicaid Financing, with Implications for ACA Marketplaces and the Individual Market

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SUMMARY

The Centers for Medicare & Medicaid Services (CMS) issued the Amending the Indirect Hold Harmless Threshold of Health Care-Related Taxes Proposed Rule (CMS-2452-P) on July 14, 2026, to implement Section 71115 of the 2025 budget reconciliation legislation (P.L. 119-21), known as the Working Families Tax Cut (WFTC). The proposal focuses primarily on Medicaid financing and state provider taxes but also raises questions for states that fund programs through assessments on commercial health insurers. This white paper looks at the potential impact of the proposal on the individual market.

WHAT SECTION 71115 OF THE WFTC ACT DID

Historically, the Medicaid provider tax rules under Section 1903(w) of the Social Security Act allowed states to satisfy the federal indirect hold harmless test if a healthcare-related tax remained below a generally applicable 6% threshold. Section 71115 replaced that uniform standard with state-specific and provider class-specific limits.

For expansion states, the allowable threshold will be phased down beginning in fiscal year 2028 and ultimately fall to 3.5% by 2032. For non-expansion states, the allowable threshold generally remains tied to the state's tax structure as of July 4, 2025. Additionally, no state will be allowed to increase taxes on a class of providers above 2025 rates, and no new taxes may be established.

Under Section 1903(w) of the Social Security Act, taxes that do not comply with federal provider tax requirements may result in reductions to the Medicaid expenditures eligible for Federal Financial Participation (FFP). As a result, states could face a loss of federal Medicaid matching funds associated with the use of noncompliant taxes to finance Medicaid.

The proposed rule contains no substantial revisions to the long-standing broad-based requirements for healthcare-related taxes. Instead, CMS proposes to apply the existing provider tax framework, including broad-based, uniformity, and hold harmless requirements, to a new permissible class for "services of health insurers."

WHAT CMS IS PROPOSING

The proposed rule would establish a new permissible class called "services of health insurers." CMS proposes that this class include issuers that offer coverage in the individual market, group market, catastrophic plans, short-term limited duration insurance (STLDI), and certain excepted benefit products, such as dental-only and vision-only coverage. Managed care organizations would be excluded because they are covered under an existing permissible class.

CMS explains that a healthcare-related tax on this class could include assessments on premium revenue or covered lives and would extend to a range of health insurance products. CMS further proposes that taxes imposed on this new class would be subject to the same indirect hold harmless framework established by Section 71115. The thresholds would apply to each class (i.e., if individual market issues are subject to the rule they would be subject to a 3.5% assessment in 2032).

WHY STATES ARE PAYING ATTENTION

In addition to the significant impacts on Medicaid, the proposal creates uncertainty for states that rely on insurer assessments to support programs outside Medicaid. At present, 20 State-Based Marketplaces (SBMs) cover approximately over 7 million enrollees, and 19 states have Section 1332 waivers to implement reinsurance programs, which have lowered premiums approximately 4–40% in the individual market.

Many SBMs, reinsurance programs, and Section 1332 waiver initiatives are financed through various mechanisms, including state assessments on commercial insurance premiums. These assessments are typically designed to support the commercial insurance market—not Medicaid financing.

If CMS interprets the statute broadly, states could face limitations on their ability to increase existing insurer assessments or establish new assessments after July 4, 2025. Those limitations could be challenging in the current environment where states are implementing other WFTC requirements like work requirements and where Marketplace enrollment has dropped in part by the expiration of enhanced Premium Tax Credits. For example:

- A state that funds its SBM through an insurer assessment may be constrained in its ability to increase that assessment in the future.
- A state seeking to establish a new SBM, reinsurance program, or state funding mechanism to support a section 1332 waiver to implement a reinsurance program could face questions about whether a new insurer assessment would be permissible if imposed after July 4, 2025.
- Existing insurer assessments could become subject to the new hold harmless thresholds if CMS determines they fall within the new permissible class.

WHERE FURTHER CLARIFICATION IS NEEDED

The proposal is framed as a Medicaid financing rule under Section 1903(w) of the Social Security Act, and CMS explains that noncompliant healthcare-related taxes reduce a state's medical assistance expenditures before federal financial participation (FFP) is calculated. What makes the proposal difficult to interpret is that Section 1903(w) has historically focused on taxes associated with Medicaid financing. In contrast, SBM assessments and state assessments that fund reinsurance and other programs as part of Section 1332 waiver programs are generally imposed to support commercial market programs. Section 1311(d)(5)(A) of the Affordable Care Act (ACA) contemplates that Marketplaces may generate funding to support Exchange operations. The proposed rule creates uncertainty regarding whether assessments imposed to fund Marketplaces could be subject to the Medicaid provider tax framework and the new indirect hold harmless thresholds established under Section 71115.

The proposed rule is unclear as to whether CMS intends to apply these new insurer tax limitations:

- **Only to taxes associated with Medicaid financing**, consistent with the traditional application of Section 1903(w); or
- **More broadly to any health insurer assessment**, regardless of what program the assessment supports: Medicaid, a State-Based Marketplace, Section 1332 waiver implementing a reinsurance program, or other non-Medicaid activities.

If CMS intends the latter, the burden may fall on states to establish that no funding generated by the health insurer assessment is used to draw down federal matching funds for the Medicaid program, and outline the process for that.

The proposal also is vague in identifying the universe of providers that must be included in this provider class in order to be considered broad-based and whether waivers or exceptions may be available for unique state circumstances.

HOW THIS COMPARES TO THE 2019 MFAR PROPOSAL

CMS has explored adding health insurers as a permissible tax class in the past. In the 2019 Medicaid Fiscal Accountability Regulation (MFAR) proposed rule, CMS similarly proposed creating a permissible class for the services of health insurers and described a broad category that included individual market, group market, catastrophic coverage, Medicare-related premium revenue, and other commercial insurance products.

The 2019 proposal, however, was issued before Congress enacted Section 71115 and therefore before the new state-specific hold harmless thresholds existed. The latest proposal would place this newly created insurer class directly into the WFTC hold harmless framework, potentially creating consequences for insurer assessments that did not exist under previous legislation.

CMS ultimately withdrew and did not finalize this provision in the MFAR rule, leaving the insurer tax class proposal unimplemented. The current rule revives a similar concept but in a significantly different statutory environment.

LOOKING AHEAD

The proposed rule centers on implementing Section 71115's Medicaid financing reforms, but its potential reach may extend well beyond traditional Medicaid provider taxes. States, Marketplaces, insurers, and 1332 waiver programs will likely be looking for CMS to clarify whether the proposed insurer tax framework applies only to Medicaid-related financing arrangements or whether it could also affect commercial market assessments used to fund SBMs, reinsurance programs, and other state affordability initiatives. Until CMS provides additional guidance, that question remains unresolved.

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