

How Federal Regulations Impact Ohio Sales Tax Revenue

Overview

- Since 2014, the Kasich Administration has been examining options to resolve federal concerns about the application of the Ohio sales tax to Medicaid managed care organizations (MCOs).¹ Without a federally-approved plan in place by July 2017, the state will face more than a billion dollar budget shortfall over the next two years.
- Ohio – like many states – is seeing tax revenue fall short of earlier estimates. With the development of the state’s next budget underway, the Administration felt an urgent need to address this billion-dollar uncertainty by requesting a waiver to replace the current tax program with an alternative that resolves federal concerns.
- The federal Centers for Medicare and Medicaid Services (CMS) approved Ohio’s waiver request in December 2016, and Ohio Medicaid incorporated the sales tax replacement into the state fiscal year (SFY) 2018-2019 operating budget.

Background

- Federal law permits states to impose taxes on a number of classes of health care items and services without affecting federal Medicaid matching funding.² The State of Ohio currently administers a 2.7 percent hospital franchise fee, 5.5 percent nursing facility franchise fee, and 1.0 percent health insuring corporation (HIC) premium tax, each of which is permissible according to the federal government.
- From 2005 to 2009, the State of Ohio also collected a 5.5 percent Medicaid MCO tax in addition to the 1.0 percent HIC premium tax. At the time, this was permissible under federal law, but the Deficit Reduction Act of 2005 broadened the federal definition of permissible class in 2009 to include all HICs, not just Medicaid MCOs.
- Rather than extend the 5.5 percent Medicaid MCO tax to non-Medicaid plans, the Strickland Administration instead repealed the Medicaid MCO tax in September 2009, and replaced the lost revenue by applying the 5.5 percent state sales tax to the capitation amounts paid to Medicaid MCOs. The state’s position has been that the federal government has no jurisdiction to interfere with the state sales tax.³
- In July 2014, CMS [advised state Medicaid directors](#) that “taxing a subset of health care providers at the same rate as a statewide sales tax” is subject to the definition of a health care related tax and not permissible. CMS gave states “until the end of the next regular legislative session” to comply, which for Ohio is June 30, 2017.⁴

¹ The sales tax law (ORC 5739.01) refers to these organizations as Medicaid Health Insuring Corporations (MHICs).

² [Section 1903\(w\)\(7\)\(A\) of the Social Security Act](#).

³ Federal regulations that govern health care related taxes *do not apply* if the tax is broad based (less than 85% of the taxpayers provide or pay for health care) and individuals or entities providing or paying for health care are treated the same as other taxpayers (e.g., the same tax rate). Because the Ohio sales tax is broad based (less than 85% of the taxpayers provide or pay for health care) and the Medicaid MCOs are treated the same as other taxpayers (5.5% rate) the state’s position has been – and remains – that the Ohio sales tax is not a health care related tax and therefore not subject to federal jurisdiction.

⁴ Each state with a similar tax (CA, PA, and MI) has already complied with the CMS guidance and eliminated the tax.

- As a result of the CMS directive, the state of Ohio will forego \$597 million in federal payments in SFY 2018 that otherwise would have been collected by applying the sales tax to Medicaid MCOs. In addition, counties and local taxing authorities will forego \$207 million that otherwise would have accrued to them under the sales tax (Table 1).

Table 1. Ohio Medicaid Managed Care Organization (MCO) Sales Tax: Impact on State, Local and Federal Funds (SFY 2018)

Medicaid MCO		State	Local	Federal
Medicaid MCOs pay 7.05% sales tax on \$15.0 billion in services	\$(1.1 billion) (7.05%)	\$916 million (5.75%)	\$207 million (1.3%)	\$0
Medicaid MCOs are reimbursed 100% of the cost of the sales tax	\$1.1 billion	\$(319 million)	\$0	\$(804 million)
NET IMPACT	\$0	\$597 million	\$207 million	\$(804 million)

CMS-Approved Waiver

- In November 2016, Ohio Medicaid requested a waiver from the broad-based uniformity requirements in Title XIX of the Social Security Act (SSA). CMS is required to approve waivers of this type if the net impact of the tax is generally redistributive as defined by federal regulation, and Ohio Medicaid demonstrated this was true.⁵
- Ohio received an approval letter from CMS on December 7, 2016 (attached). The CMS letter specifies the tax rate that will be paid by Medicaid MCOs (\$26 to \$56 per member month) and non-Medicaid major medical managed care plans (\$1 to \$2 per member month). As a result, the state of Ohio will collect an estimated \$858 million annually from the federally-approved sales tax replacement (Table 2).

Table 2. Ohio Medicaid Managed Care Organization (MCO) Sales Tax Replacement: Impact on Collections by Type of Plan (SFY 2018)

Type of Plan	Tax Range	Member Months	Annual Collection
Medicaid MCO	\$26 to \$56 per member month	30.8 million	\$854 million
Non-Medicaid Major Medical Plan	\$1 to \$2 per member month	2.7 million	\$4 million
TOTAL			\$858 million

⁵ Per Section 1903(w)(3)(E) of the SSA, the Secretary of the U.S. Department of Health and Human Services shall approve the uniformity (and broad-based) waiver request if the net impact of the tax is generally redistributive, as determined through a statistical demonstration using a linear regression model that compares the slopes of two lines. If the result of that calculation is equal or greater than one, then the waiver shall be approved. Ohio's calculation was 1.001 and thus approval was guaranteed under the law.

- Medicaid MCOs will recover the entire cost of the sales tax replacement (\$854 million annually) because that cost is an allowed expense that is reimbursed by Ohio Medicaid and CMS. Non-Medicaid major medical plans do not similarly get reimbursed for the cost of the tax, but the cost across these plans is significantly less (\$4 million annually).
- After reimbursing the Medicaid MCOs for the state share of the tax (\$243 million), the net benefit to the state is estimated to be \$615 million (Table 3). This amount replaces the \$597 million in net benefit that the state otherwise would have received from the Medicaid MCO sales tax (refer back to Table 1).

Table 3. Ohio Medicaid Managed Care Organization (MCO) Sales Tax Replacement: Impact on Plans and State, Local and Federal Funds (SFY 2018)

Plans		State	Local	Federal
Medicaid MCOs and major medical plans pay the replacement tax	\$(858 million)	\$858 million	\$0	\$0
Medicaid MCOs are reimbursed 100 percent of the cost of the tax	\$854 million	\$(243 million)	\$0	\$(611 million)
NET IMPACT	\$(4 million)	\$615 million	\$0	\$(611 million)

Local Transition Assistance

- The sales tax replacement does not generate revenue for local taxing authorities. In June 2016, the Office of Budget and Management (OBM) notified county leaders about the potential loss of sales tax revenue.
- The Executive Budget provides two types of sales tax replacement transition assistance to counties and transit authorities: (1) a revenue replacement calculation for the last quarter of calendar year 2017 and (2) formula loss assistance post-calendar year 2017.
- A revenue replacement calculation will be provided to all 88 counties and eight transit authorities to completely replace revenue lost from October 1, 2017 to December 31, 2017 as a result of repealing the Medicaid MCO sales tax (the first sales tax distribution where any local loss would be felt is October 2017). This form of aid amounts to \$49 million, with the payments to be made late in calendar year 2017.
- Formula loss assistance will be provided in one lump sum based on a multi-year formula that considers each taxing authority’s reliance on the Medicaid MCO sales tax, actual Medicaid MCO sales tax distributions, per capita sales tax base, and total permissive sales tax distributions. This form of aid amounts to \$158 million, with payments made in calendar year 2017. All eight transit authorities and 80 counties will receive revenue loss assistance. The eight counties that do not receive assistance have Medicaid MCO sales tax revenues of less than four percent of total sales tax revenues.



John B. McCarthy, Director
Ohio Department of Medicaid
P.O. Box 182709
50 West Town Street, Suite 400
Columbus, Ohio 43218

DEC 07 2016

Dear Mr. McCarthy,

This is in response to your request for waiver of the broad-based and uniformity requirements related to your managed care organization (MCO) tax. Ohio is requesting this waiver as an update to its previous MCO tax to satisfy CMS' updated policy requirements. Upon review and consideration of the information formally provided to the Center for Medicare & Medicaid Services (CMS) on November 09, 2016, I am pleased to inform you that your request for 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 Ohio requested waiver would be imposed as follows beginning state fiscal year (SFY) 2018:

- Cumulative Ohio Medicaid member months from 0 to 250,000 are taxed \$56.00 per month;
- Cumulative Ohio Medicaid member months from 250,001 to 500,000 are taxed \$45.00 per month;
- Cumulative Ohio Medicaid-member months in excess of 500,000 are taxed \$26.00 per month;
- Cumulative Other member months from 0 to 150,000 are taxed \$2.00 per month;
- Cumulative Other member months in excess of 150,000 are taxed \$1.00 per month.

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.

The federal regulation at 42 CFR 433.68(e)(2) describes the statistical test necessary for a state to demonstrate that the proposed structure is generally redistributive. Ohio's statistical demonstration is addressed below. Moreover, the federal regulation at 42 CFR 433.68(f) describes the circumstances in which a hold harmless arrangement would exist. Upon review of the Ohio statute implementing the proposed MCO tax and the review of Ohio's proposed methodology for increasing Medicaid reimbursement to managed care organizations, it appears that no hold harmless arrangement exists between the associated increases in Medicaid reimbursement.

To determine the generally redistributive nature of the proposed member month tax, Ohio calculated the slope (expressed as B1) of a linear regression for a broad-based and uniform tax in which the dependent variable was each MCO's percentage share of the total tax paid, if the tax was uniformly imposed on all member months in the state and the independent variable was each MCO's Medicaid member months. Ohio 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 MCO's percentage share of the total tax paid and the independent variable was the number of Medicaid member months for each MCO.

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 tax is **1.0001**.

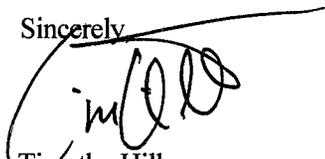
Therefore, we are able to approve your request to modify your waiver of the broad-based and uniformity provisions of sections 1903(w)(3)(B) and (C) of the Act for the proposed MCO tax. Please be advised that any future changes to the taxing structure, including a non-uniform change to the approved tax rates, will require the State of Ohio to submit a new broad-based and/or uniformity waiver request.

The 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 Ohio's initial request for waiver of the broad-based and uniformity requirements on November 09, 2016, with a requested effective date of July 1, 2017. Therefore, the effective date of Ohio's request for waiver of the broad-based and uniformity requirements is July 1, 2017.

CMS reserves the right to perform a financial management review at any time to ensure that the state operation of the tax on nursing facilities 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 Rich Cuno at (410) 786-1111.

Sincerely

A handwritten signature in black ink, appearing to read 'Timothy Hill', is written over a horizontal line. The signature is stylized and cursive.

Timothy Hill
Deputy Director