



SUBJECT: Section 71115 and 71117 of Working Families Tax Cuts Legislation on Provider Taxes

November 14, 2025

Dear Colleague:

On July 4, 2025, President Trump signed into law Public Law 119-21, which contained the “Working Families Tax Cuts Legislation,” (WFTCL). This bill includes significant eligibility and financing reforms in Medicaid and CHIP, while implementing comprehensive measures to eliminate waste, fraud, and abuse.

Section 71115 of WFTCL amended the statutory indirect hold harmless threshold applicable for health care-related taxes, effective October 1, 2026. This provision of WFTCL sets the indirect hold harmless threshold equal to either: (1) for non-expansion states, no more than the applicable percent of net patient revenue for health care-related taxes enacted and imposed as of July 4, 2025 or (2) for expansion states, the lower of the July 4, 2025, applicable percent or the applicable phase down amount beginning in fiscal year (FY) 2028. Effectively, this provision will generally prevent increases to pre-existing health care-related taxes and the imposition of new health care-related taxes, as the indirect hold harmless threshold would be 0 (zero) percent for taxes that were not enacted and imposed as of July 4, 2025.¹ Section 71115 also stipulates that beginning in FY 2028, the threshold is also subject to a five-year phase down for applicable Medicaid expansion states.² In this letter, CMS is providing preliminary guidance on the meaning of the phrase, “has enacted a tax and imposes such tax,” as used in section 71115. We are also providing information about the handling of pending tax waivers.

In addition, section 71117 of WFTCL codified additional standards with respect to when a health care-related tax is not considered generally redistributive under section 1903(w) of the Social Security Act (the Act). The law also authorized the Secretary to provide states with a transition period in connection with the amendments made by section 71117, not to exceed three fiscal years. This letter is to inform states that we are providing a limited transition period for certain health care-related taxes as authorized in section 71117(c) of WFTCL.

¹ If a state’s health care-related tax produces revenue that exceeds the applicable percentage, then the tax fails the first prong of the indirect hold harmless test in 42 CFR § 433.68(f)(3)(i)(A). However, in that case, the tax may still be determined not to involve an indirect hold harmless arrangement if it satisfies the second prong of the test, specified in 42 CFR § 433.68(f)(3)(i)(B). To pass the second prong, 75 percent or more of taxpayers in the class must not receive 75 percent or more of their total tax costs back in enhanced Medicaid payments or other state payments. Although section 71115 does not eliminate the second prong of the indirect hold harmless test, in practice, this secondary test is virtually never satisfied.

² Section 71115(a)(2) defines an expansion state as “a State that, beginning on January 1, 2014, or on any date thereafter, elects to provide medical assistance to all individuals described in section 1902(a)(10)(A)(i)(VIII) under the State plan under this title or under a waiver of such plan.”

This information is being provided as preliminary guidance to aid state planning efforts. CMS understands the need for relevant and timely information for Medicaid decision makers.

Background

Section 1903(w) of the Act establishes requirements for health care-related taxes. In general, taxes must be imposed on a permissible class of items or services and must be broad-based (all providers are taxed) and uniform (providers are taxed at the same rate), unless a waiver is approved. 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 determined to be “generally redistributive in nature” and the amount of the tax is not directly correlated to Medicaid payments for items or services with respect to which the tax is imposed. Finally, the statute also prohibits multiple types of hold harmless arrangements, including those that guarantee taxpayers receive their tax cost back through Medicaid or other payments.

Regulations specify two specific types of hold harmless arrangements that involve guarantees: direct and indirect. A direct hold harmless occurs when a state makes a payment (whether the state makes a direct payment or an indirect payment, including when payments are redistributed through an intermediary) that guarantees repayment of all or a portion of a provider’s tax cost. An indirect hold harmless occurs when the state taxes health care providers at a high rate relative to their revenue, historically set to 6 percent, resulting in a presumption that the tax costs will be repaid to the taxpayer through increased Medicaid payments, after the state draws down federal financial participation. This indirect hold harmless threshold of 6 percent of net patient revenue (on a per provider class basis) was set by regulation,³ and it was subsequently codified in statute through the Deficit Reduction Act of 2005.⁴ In almost all cases, this 6 percent indirect hold harmless threshold thresholds the amount each state can collect in provider taxes on a per class basis. If a state’s tax collection exceeds this threshold, then the entire tax collection may be deducted from a state’s Medicaid expenditures.⁵

Section 71115 – New Indirect Hold Harmless Thresholds

Effective October 1, 2026, section 71115 of WFTCL amends section 1903(w)(4) of the Act (42 U.S.C. 1396b(w)(4)) to establish new indirect hold harmless thresholds. Except as provided for expansion states, the applicable threshold for each state⁶ and permissible class will be equal to the applicable percent of net patient revenue for taxes that are enacted and imposed as of the date of enactment, July 4, 2025. This change generally prohibits new or increased provider taxes that would cause tax collection for a permissible class in a state to exceed the new indirect hold harmless threshold.

³ 42 CFR 433.68(f)(3)(i)(A).

⁴ [Public Law No: 109-171](#).

⁵ Section 1903(w)(1)(A)(iii) of the Act and 42 CFR 433.70(b).

⁶ These changes do not apply to the territories, as provided in section 71115(b).

Section 71115 also establishes a separate phase-down for expansion states for certain permissible classes.⁷ Beginning in FY 2028, the applicable threshold will be the lower of the July 4, 2025, applicable percent of net patient revenue or 5.5 percent. This percentage will decrease by 0.5 percent each subsequent year until it reaches 3.5 percent in FY 2032, and for FY 2032 and each subsequent fiscal year, the threshold for an expansion state by permissible class will be the lower of 3.5 percent or the July 4, 2025, applicable percent.

CMS is gathering more detailed data about existing taxes to ensure the new thresholds are applied appropriately and consistently. This should aid federal oversight and state planning efforts by providing an early indication of where their thresholds may fall, until states are notified of their final indirect hold harmless thresholds for each permissible class following rulemaking. This information is preliminary in nature and final policies will depend on the contents of a final rule.

Enacted and Imposed

The new indirect hold harmless thresholds established by section 71115 of WFTCL take effect on October 1, 2026. However, the new thresholds are based on the applicable percent of net patient revenue attributable to the permissible class for a tax, provided that a state or locality “has enacted a tax and imposes such tax” as of July 4, 2025. The following describes the meaning of those terms, followed by additional information as to how they impact the applicable net patient revenue calculation:

Enacted: We consider a tax to be enacted when both of the following circumstances are met:

- The applicable state or local government has completed the entire legislative process necessary to authorize the tax (either initially or to amend an existing tax) that supports the specific tax structure that is in effect on July 4, 2025. *Note: The enacted tax structure as of July 4, 2025, does not include administrative (e.g. through a state budget office) or legislative adjustments to a tax structure (including revenue increases) after July 4, 2025, even if retroactively applicable.*
- If the tax requires a broad-based and/or uniformity tax waiver, CMS has approved the tax waiver as of July 4, 2025.

Imposed:

- A state or local government (directly or by way of a delegated administrative agency) was actively collecting revenue, as of July 4, 2025, associated with the specific enacted tax structure in effect on that date.
 - In the case where a state collects taxes on a delayed schedule consistent with routine collection or billing practice, the collection is applicable as of July 4, 2025, and based on the specific enacted tax structure in effect on that date.

⁷ Taxes on nursing facility services or intermediate care facility services for individuals with intellectual disabilities will not be subject to the phase down under section 1903(w)(4)(D)(iv) of the Act, as established by section 71115(a)(2) of OBBBA.

In other words, “enacted” refers to whether the authority to tax was provided by the relevant authorizing entity/entities by July 4, 2025, and “imposed” refers to whether the tax was actually implemented as of July 4, 2025.

Pending Tax Waiver Requests

As noted above, section 71115 generally prohibits new or increased provider taxes that would cause tax collection for a permissible class in a state to exceed the new indirect hold harmless threshold. Based on the above description of “enacted” and “imposed,” revenues associated with tax waiver proposals that were pending on or submitted after July 4, 2025, will not be included in the new indirect hold harmless threshold. CMS will calculate thresholds associated with the tax structure in effect with the most recent waiver approval for the tax, and for which the state is actively collecting revenue.

Section 71117 – Closing a Regulatory Loophole

Section 1903(w) of the Act and CMS regulations at 42 CFR § 433.68 allow states to request a waiver of the broad-based and uniformity requirements, and those regulations specify statistical tests to determine whether the non-broad-based or uniform tax is still generally redistributive. States have exploited an unintended loophole in the statistical test for non-uniform taxes that enabled some states to design taxes shifting a disproportionate share of costs to the federal government without the state bearing the requisite non-federal share.⁸

Section 71117 closes this loophole by specifying circumstances in which a health care-related tax is not considered generally redistributive. Specifically, section 71117 of WFTCL amends section 1903(w) of the Act to provide that a health care-related tax will not be considered generally redistributive if:

- Within a permissible class, the tax rate imposed on any taxpayer or tax rate group explicitly defined by its relatively lower volume or percentage of Medicaid taxable units is lower than the tax rate imposed on any other taxpayer or tax rate group explicitly defined by its relatively higher volume or percentage of Medicaid taxable units;
- Within a permissible class, the tax rate imposed on any taxpayer or tax rate group based upon its Medicaid taxable units is higher than the tax rate imposed on any taxpayer or tax rate group based upon its non-Medicaid taxable units; or
- The tax has the same effect as the first two provisions by identifying a taxpayer or tax rate group based on or defined by any description, even without naming Medicaid explicitly.

⁸ CMS issued a proposed rule on May 15, 2025, to close this loophole. See Medicaid Program; Preserving Medicaid Funding for Vulnerable Populations – Closing a Health Care-Related Tax Loophole Proposed Rule, 90 FR 20578 (May 15, 2025).

Transition Periods

Section 71117(c) authorized the Secretary to grant transition periods to states⁹ with non-compliant taxes, for a period not to exceed three fiscal years. This letter informs states that we are providing the following transition periods in accordance with section 71117(c) of WFTCL:

- For health care-related taxes on services of managed care organizations (MCO) that exploit the loophole for which a tax waiver was approved before the date of enactment of WFTCL (July 4, 2025): **Until the end of the applicable state's fiscal year ending in calendar year 2026.**
- For all other taxes on permissible classes that exploit the loophole for which a tax waiver was approved before the date of enactment of WFTCL (July 4, 2025): **Until the end of the applicable state's fiscal year ending in calendar year 2028, but no later than October 1, 2028.**

For example, if a state has an approved MCO tax in place before July 4, 2025, that violates section 71117 (i.e., the tax is not generally redistributive as described under the new statutory standards, even if previously approved by CMS), and its next state fiscal year ends on June 30, 2026, the state will have until at least that date to address its tax. This is the minimum transition period that may be available; additional time, up to the statutory three fiscal year maximum, may be provided, and final policies will depend on the contents of the final rule in regard to the Medicaid Program; Preserving Medicaid Funding for Vulnerable Populations – Closing a Health Care-Related Tax Loophole Proposed Rule, 90 FR 20578. If that same example state has an approved inpatient hospital services tax in place before July 4, 2025, that would violate section 71117, the state would have until June 30, 2028.

In our work with states to identify and understand these taxes that exploit the statistical loophole, we have found that the most egregious examples of shifting the burden of financing Medicaid to the federal government exist in MCO taxes. For example, one approved MCO tax waiver that exploits the loophole imposes a rate on Medicaid taxable units that is 117 times higher than comparable commercial business. Conversely, a hospital tax that exploits the loophole taxes Medicaid 3.5 times higher than comparable commercial business. As such, CMS oversight prioritized quickly identifying MCO taxes that appear to exploit the loophole, and we have expressed concerns to states with such taxes, in most cases before state implementation of the loophole tax. Although we believe states have been on clear notice that CMS considered these loophole taxes problematic and was likely to address them through rulemaking even in the absence of further statutory requirements, due to state budgetary and legislative considerations, we are providing states with the limited transition period described above for existing MCO loophole taxes to come into compliance.

In addition to MCO taxes that utilized the loophole, a small number of state taxes on other permissible classes also relied on it. These non-MCO taxes generally shift a smaller share of costs to the federal government than MCO taxes and are less common. Accordingly, CMS is

⁹ Section 71117 does not apply to the territories, as provided in section 71117(b).

providing additional transition time for these classes, so that states can first prioritize bringing MCO taxes into compliance, given their greater impact on Medicaid fiscal integrity.

Interaction of Sections 71115 and 71117

All taxes will be subject to the new indirect hold harmless thresholds established by section 71115. All current and future taxes will also be subject to the modified generally redistributive requirements under section 71117; however, only a subset of current health care-related taxes exploit the loophole closed by section 71117, thus only some states will need to take action to modify existing taxes to comply with section 71117. We do not believe the new thresholds established by section 71115 will inhibit the ability of those states to amend their loophole taxes to comply with section 71117 within applicable indirect hold harmless thresholds. We are available, as always, to provide technical assistance to any state with concerns about this interaction.

Next Steps

We intend to address the information and issues identified in this letter through notice-and-comment rulemaking. With respect to the section 71117(c) transition periods, CMS recommends that affected states carefully consider how to avoid or mitigate any possible budgetary and/or program challenges in this interim period and take appropriate action. Uniform increases in provider tax rates after the date of WFTCL's enactment are not covered by the transition, nor are new or pending waiver requests. The transition period policy discussed in this letter represents the minimum transition period (in the case of MCO taxes that exploit the loophole) that states will have to bring non-compliant tax waivers into conformity with the requirements added by section 71117 of WFTCL.

Closing

CMS is committed to working with states to address fraud, waste, and abuse and to improve the fiscal integrity of the Medicaid program, and ensuring that provider taxes comply with federal requirements, including sections 71115 and 71117 of WFTCL. We thank you for your attention to these matters and for your collaboration. If you have any questions about this guidance or need technical assistance, please contact taxwaiver@cms.hhs.gov.

Sincerely,

/s/

Dan Brillman
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Director, Center for Medicaid and CHIP Services