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**SUBJECT: Section 71116 of the Working Families Tax Cuts Legislation on State Directed Payments**

February 2, 2026

Dear Colleague:

Section 71116 of Public Law 119-21 (which CMS refers to as the “Working Families Tax Cuts” (WFTC) legislation)<sup>1</sup> became effective for Medicaid managed care rating periods<sup>2</sup> beginning on or after July 4, 2025. Section 71116 directed the Centers for Medicare & Medicaid Services (CMS) to revise 42 CFR § 438.6(c)(2)(iii) to reduce the total payment rate limit for state directed payments (SDP) for inpatient hospital services, outpatient hospital services, nursing facility services, or qualified practitioner services at an academic medical center.<sup>3</sup> Section 71116 also included a provision temporarily grandfathering certain SDPs until the rating period beginning on or after January 1, 2028.<sup>4</sup>

CMS is preparing a notice of proposed rulemaking to revise 42 CFR part 438 as required by section 71116 and consistent with the Presidential directive outlined in the Presidential Memorandum, dated June 6, 2025.<sup>5</sup> As part of this rulemaking effort, CMS is considering changes to the total payment rate limit for SDPs for other services beyond the four services mandated by section 71116.

To aid state planning efforts until a final rule is promulgated, CMS is providing guidance on section 71116. This information is preliminary in nature and final policies will depend on the contents of the final rule. Certain SDPs will qualify for the temporary grandfathering period, including SDPs with rating periods for calendar year (CY) 2024, state fiscal year (SFY)<sup>6</sup> 2025, CY 2025, SFY 2026, and CY 2026 for which a completed preprint was submitted to CMS before May 1, 2025, or, for some SDPs, before July 4, 2025. In addition, SDPs for these periods for which we determine that the state made a good faith effort to obtain approval before the applicable date (May 1, 2025 or July 4, 2025), as further explained in the “Grandfathering Certain SDPs” section below, will qualify for the grandfathering period.

## **Background**

SDPs permit states to implement contractual Medicaid managed care arrangements that direct a managed care organization’s, prepaid ambulatory health plan’s, or prepaid inpatient health plan’s expenditures under 42 CFR § 438.6(c). The use of SDPs has grown substantially since they were

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<sup>1</sup> Public Law 119-21.

<sup>2</sup> Rating period is defined in 42 CFR § 438.2.

<sup>3</sup> Inpatient hospital services, outpatient hospital services, nursing facility services, or qualified practitioner services at an academic medical center are defined in 42 CFR § 438.6(a).

<sup>4</sup> Section 71116 applies to all 50 states and the District of Columbia but does not apply to U.S. territories.

<sup>5</sup> <https://www.whitehouse.gov/presidential-actions/2025/06/eliminating-waste-fraud-and-abuse-in-medicaid/>

<sup>6</sup> The term “state fiscal year” is used for ease of reference and is assumed to be the same as a state’s annual rating period that begins in a month other than January. A rating period is defined in 42 CFR § 438.2 as a 12-month period and can begin in any month.

first introduced in 2016; in CY 2024, CMS received more than 330 SDP preprint submissions from 39 states and territories. For federal fiscal year (FFY) 2024, CMS’s Office of the Actuary (OACT) projected that annual SDP spending exceeded \$97.8 billion (total computable) and projected that spending would increase to approximately \$124.3 billion (total computable) for FFY 2025 and \$144.6 billion for FFY 2026, representing a significant proportion of Medicaid managed care expenditures.

## **Section 71116**

Section 71116(a) requires that the total payment rate for any SDP for inpatient hospital services, outpatient hospital services, nursing facility services, or qualified practitioner services at an academic medical center furnished during a rating period beginning on or after July 4, 2025, be limited to:

1. 100 percent of the specified total published Medicare payment rate<sup>7</sup> (or, in the absence of a specified total published Medicare payment rate, the payment rate under the Medicaid state plan (or under a waiver of such plan)) for an expansion state;<sup>8</sup> or
2. 110 percent of the specified total published Medicare payment rate (or, in the absence of a specified total published Medicare payment rate, the payment rate under the Medicaid state plan (or under a waiver of such plan)) for a non-expansion state.

A limited exception to section 71116(a) is permitted for SDPs that qualify for the grandfathering period in section 71116(b).

## **Grandfathering Certain SDPs**

### *Applicable Rating Period Criteria*

Section 71116(b) stipulates that SDPs meeting certain criteria are eligible for a temporary grandfathering period. One such criterion is the rating period. More specifically, certain SDPs in rating periods occurring within 180 days of the date of enactment of section 71116 are eligible for the grandfathering period. CMS interprets this to mean that the grandfathering period would apply to SDPs in rating periods occurring 180 business days before or 180 business days after July 4, 2025. We believe 180 business days<sup>9</sup> is an appropriate interpretation to acknowledge that activity on SDP preprints, including CMS review and approval, occurs on business days and not on weekends or Federal government holidays. In practice, this means the grandfathering period applies to eligible SDPs in rating periods that include any days from October 11, 2024 through

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<sup>7</sup> Total published Medicare payment rate is defined in 42 CFR § 438.6(a).

<sup>8</sup> Section 71116(a)(1) defines an expansion state as “a State that provides coverage to all individuals described in section 1902(a)(10)(A)(i)(VIII) of the Social Security Act (42 U.S.C. 1396a(a)(10)(A)(i)(VIII)) that is equivalent to minimum essential coverage (as described in section 5000A(f)(1)(A) of the Internal Revenue Code of 1986 and determined in accordance with standards prescribed by the Secretary in regulations) under the State plan (or waiver of such plan) of such State under title XIX of such Act.”

<sup>9</sup> For purposes of this guidance, CMS defines “business day” as Monday through Friday, excluding the Federal holidays as determined under 5 U.S.C. § 6103. These holidays include the 12 Federal holidays, including Inauguration Day, as recognized by the Office of Personnel Management (<https://www.opm.gov/policy-data-oversight/pay-leave/federal-holidays>). Federal government closures by Executive Order applicable to this timeframe and known at the time of publication include [December 24, 2024](#), [January 9, 2025](#), [December 24, 2025](#) and [December 26, 2025](#).

July 3, 2025, or July 7, 2025 through March 27, 2026.<sup>10</sup> For example, this could include eligible SDPs, as described below, in rating periods occurring in CY 2024, SFY 2025, CY 2025, SFY 2026 and CY 2026; however, this would not include SDPs in other rating periods, such as those occurring in SFY 2027 (i.e., rating periods beginning on or after March 30, 2026).

### *Preprint Status Criteria*

Section 71116(b) specifies additional criteria SDPs must meet to qualify for the grandfathering period. The criteria are:

- (1) SDPs (other than for rural hospitals<sup>11</sup>) for which written prior approval<sup>12</sup> was made by CMS before May 1, 2025;
- (2) SDPs (other than for rural hospitals) for which a good faith effort to receive CMS approval was made before May 1, 2025;
- (3) SDPs for rural hospitals for which written prior approval was made by CMS before July 4, 2025;
- (4) SDPs for rural hospitals for which a good faith effort to receive CMS approval was made before July 4, 2025; and
- (5) SDPs for which a completed preprint was submitted to CMS prior to July 4, 2025.

### *Definitions of “Completed Preprint” and “Good Faith Effort”*

CMS interprets the term “completed preprint” in criterion (5) above to be equivalent to the definition of a completed preprint described on page 6 of the CMCS Informational Bulletin (CIB) published on November 7, 2023,<sup>13</sup> which states that “[a] complete State directed payment preprint submission requires a State directed payments preprint form<sup>14</sup> as well as the preprint addendum tables in an Excel workbook,<sup>15</sup> as necessary....The preprint must be completed in full, and all information must be provided only in the fillable sections of the preprint and the addendum tables.”

A state must submit a completed SDP preprint form to CMS as a good faith effort to receive CMS approval. Therefore, the term “good faith effort” in criteria (2) and (4) above are synonymous with a “completed preprint.” CMS also notes that there is no practical difference in giving a broader meaning to “good faith effort” for criteria (2) and (4), because under any reasonable interpretation of this phrase, we have ascertained that no additional SDPs beyond those already included under criteria (1) and (5) would be included.

### *Limits for Grandfathered SDPs*

The phase down for grandfathered SDPs is effective for rating periods beginning on or after January 1, 2028. Until then, the total dollar amount of a grandfathered SDP (as specified in item

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<sup>10</sup> These calendar date examples are illustrative, based on the information known at the time of publication and the definitions of Federal holidays in 5 U.S.C. § 6103. The specific dates reflected in this example assume no additional Federal holidays or Federal government closures beyond those identified at the time of publication and may change if additional non-business days are later recognized.

<sup>11</sup> The definition of a rural hospital is specified in section 71116(d)(2).

<sup>12</sup> Written prior approval has the meaning given to such term in 42 CFR § 438.6(c)(2)(i).

<sup>13</sup> <https://www.medicaid.gov/federal-policy-guidance/downloads/cib11072023.pdf>

<sup>14</sup> <https://www.medicaid.gov/sites/default/files/2022-12/sdp-4386c-preprint-template-12192022.pdf>

<sup>15</sup> The preprint addendum is an Excel document, entitled “Section 438.6(c) Preprint Addendum Tables” which can be downloaded from [here](#).

4 of the current SDP preprint form) cannot increase and a state cannot increase this amount under any change or revision to the grandfathered SDP, including a revision to the preprint,<sup>16</sup> amendment SDP,<sup>17</sup> or renewal SDP.<sup>18</sup> However, states may choose to decrease this amount at any time.

If a state's SDP qualifies for the grandfathering period under more than one rating period (e.g., SFY 2025 and SFY 2026), CMS will permit the SDP with the higher total dollar amount to be grandfathered.<sup>19</sup> Grandfathered SDPs must comply with the total payment rate limit and must not exceed 100 percent of the average commercial rate as specified in 42 CFR § 438.6(c)(2)(iii). Further details on the phase down requirements will be proposed as part of rulemaking.

## Next Steps

Every applicable SDP preprint for inpatient hospital services, outpatient hospital services, nursing facility services, or qualified practitioner services at an academic medical center submitted to CMS before July 4, 2025, that does not qualify for the grandfathering period must comply with section 71116 for each rating period beginning on or after July 4, 2025. For these SDPs, if applicable, the state must submit a revised preprint before CMS would continue its review, as required at 42 CFR § 438.6(c)(2)(i). For example, if the state has submitted a new SDP preprint<sup>20</sup> for a SFY 2027 rating period that exceeds the applicable total payment rate limit required in section 71116(a), the state must revise the preprint before CMS would continue review. Additionally, any amendment or renewal SDP preprint that does not qualify for the grandfathering period must be revised, if necessary, to comply with section 71116 requirements before CMS would continue review.<sup>21</sup> For example, states will be required to revise any amendment or renewal SDP preprint that has a total dollar amount that is greater than the total dollar amount included in an SDP that is determined to be eligible for the grandfathering period (such as a SFY 2027 SDP renewal for a grandfathered SFY 2026 SDP).<sup>22</sup> SDPs must meet all the criteria outlined in previous sections (e.g., rating period, preprint status) to qualify as a SDP eligible for the temporary grandfathering period under section 71116(b), and states cannot revise SDP preprints in an effort to circumvent these criteria. For example, a state cannot revise the rating period of a pending or approved preprint.

As previously outlined in this letter, certain SDPs including those for a CY 2024, SFY 2025, CY 2025, SFY 2026, and CY 2026 rating period for inpatient hospital services, outpatient hospital services, nursing facility services, or qualified practitioner services at an academic medical center that were approved by CMS before the date of this letter are preliminarily grandfathered.

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<sup>16</sup> A revision to a preprint refers to a state submitting a revised preprint for a pending SDP under review by CMS.

<sup>17</sup> An amendment SDP is an SDP that specifies in Item 6(a) of the preprint form that it is an amendment.

<sup>18</sup> A renewal SDP is an SDP that specifies in Item 6(b) of the preprint form that it is a renewal.

<sup>19</sup> For example, if a state has an SDP preprint for a SFY 2025 rating period totaling \$100 million (as specified in item 4 of the preprint form) that qualifies for the grandfathering period, and an SDP preprint for a SFY 2026 rating period totaling \$105 million (as specified in item 4 of the preprint form) that qualifies for the grandfathering period, CMS would permit the state to utilize the \$105 million SDP as the grandfathered SDP.

<sup>20</sup> A new SDP is an SDP that specifies "yes" in item 5 of the preprint form.

<sup>21</sup> This example also applies to any future amendment or renewal of a grandfathered SDP.

<sup>22</sup> For example, if a state has a pending SDP preprint for a SFY 2027 rating period totaling \$55 million (as specified in item 4 of the preprint form) that is pending with CMS, and an SDP preprint for a SFY 2026 rating period totaling \$50 million (as specified in item 4 of the preprint form) that qualifies for the grandfathering period, the state would need to revise its SFY 2027 SDP to be no greater than \$50 million before CMS would continue review of the pending SFY 2027 SDP preprint.

For applicable SDP preprints that are currently under review by CMS as required at 42 CFR § 438.6(c)(2)(i), CMS will include preliminary feedback in our adjudication letters on whether that preprint is likely eligible for the grandfathering period. As a reminder, all approved SDP preprints and adjudication letters are posted on Medicaid.gov<sup>23</sup> on a routine basis. CMS will enforce all federal requirements, including section 71116, and CMS's assessment may be revised if further information is identified that revises the initial assessment or as a result of regulatory changes.

States must ensure that all SDPs comply with all federal requirements, including section 71116 and in 42 CFR part 438.

## Closing

CMS is committed to working with states to address fraud, waste, and abuse and to improve the program and fiscal integrity of the Medicaid program, and ensuring that SDPs comply with federal requirements, including section 71116. As part of CMS's standard process to review pending SDP preprints, CMS will provide preliminary feedback on whether an SDP is likely eligible for the grandfathering period as part of our standard adjudication letters. If you have any questions about this guidance, please contact [StateDirectedPayment@cms.hhs.gov](mailto:StateDirectedPayment@cms.hhs.gov).

Sincerely,

/s/

Dan Brillman  
Deputy Administrator, CMS  
Director, Center for Medicaid and CHIP Services

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<sup>23</sup> <https://www.medicaid.gov/medicaid/managed-care/guidance/state-directed-payments/approved-state-directed-payment-preprints>