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Medicaid Program; Preserving Medicaid Funding for Vulnerable Populations – Closing a Health Care-Related Tax Loophole

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Background & Key Takeaways

On January 29, 2026, the Centers for Medicare & Medicaid Services (CMS) issued a Final Rule on the Medicaid Program; Preserving Medicaid Funding for Vulnerable Populations – Closing a Health Care-Related Tax Loophole (hereinafter, "Final Rule"). The Final Rule clarifies the statistical tests that CMS uses when deciding whether a health care-related tax is generally redistributive.[1] A health care-related tax that is found to be generally redistributive allows the state to count those taxes to the state's share of Medicaid expenditures. For CMS to find that a tax is generally redistributive, the "broad-based"[2] and/or "uniform"[3] requirements associated with health care-related taxes may need to be waived.[4] In the Final Rule, CMS clarifies application of the statistical tests CMS uses in determining whether to provide a waiver for either requirement. CMS also finalizes several policies as proposed, consistent with Section 71117 of the One Big Beautiful Bill Act (OBBBA) regarding Medicaid provider taxes.[5] A key change from the Proposed Rule is that CMS provides longer transition periods for states that need to change their health care-related tax structure. CMS estimates that the Final Rule policies will reduce federal Medicaid spending by $78.2 billion from 2027 through 2036 and reduce state Medicaid expenditures by $46.9 billion over this same period.

A CMS fact sheet on the Final Rule is available here. The regulations are effective April 3, 2026. However, CMS provides transition timelines for states to change their provider taxes, if needed.

Permissible Health Care-Related Taxes—Additional Requirement To Demonstrate a Tax Is Generally Redistributive

CMS finalized additional applications of a health care-related tax that would violate the generally redistributive requirement. Specifically, CMS finalized that a health care tax would not be generally redistributive if it imposes higher tax rates on Medicaid taxable units[6] than on non-Medicaid taxable units[7] (e.g., a tax on hospitals with fewer than 5 percent Medicaid utilization at 2 percent of net patient service revenue for inpatient hospital services, while all other hospitals are taxed at 4 percent of net patient service revenue for inpatient hospital services). Additionally, CMS finalized that a tax would not be generally redistributive if it uses indirect definitions or substitutes to charge higher rates on units that are effectively Medicaid-related while taxing non-Medicaid units at lower

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[1] CMS asserts that several states structure taxes that appear to meet the agency's statistical test requirement but impose higher tax rates on entities with a greater proportion of Medicaid business than non-Medicaid business.
[2] Health care-related taxes are considered "broad-based" if applied to all providers within the assessed class.
[3] Health care-related taxes are considered "uniform" if applied at the same tax rate within an assessed class.
[4] https://www.ecfr.gov/current/title-42/chapter-IV/subchapter-C/part-433/subpart-B/section-433.68
[5] Section 71117 (Requirements Regarding Waiver of Uniform Tax Requirement for Medicaid Provider Tax) specifies requirements for when a provider tax will be considered generally redistributive for purposes of being approved for a waiver of the uniformity requirement. https://www.congress.gov/bill/119th-congress/house-bill/1/text
[6] CMS finalized defining a "Medicaid taxable unit" as "a unit that is being taxed within a health care-related tax that is applicable to the Medicaid program. This includes units that are used as the basis for Medicaid payment, such as Medicaid bed days, Medicaid revenue, costs associated with the Medicaid program such as Medicaid charges, or other units associated with the Medicaid program."
[7] CMS finalized defining a "non-Medicaid taxable unit" as ''a unit that is being taxed within a health care-related tax that is not applicable to the Medicaid program.'' This includes units that are the basis for payment by non-Medicaid payers, such as non-Medicaid bed days, non-Medicaid revenue, costs that are not associated with the Medicaid program, or other units not associated with the Medicaid program.

rates (e.g., a tax on hospitals located in counties with an average income less than 230 percent of the Federal poverty level of $10 per inpatient hospital discharge, while hospitals in all other counties are taxed at $5 per inpatient hospital discharge). To ensure state taxes are permissible and generally redistributive, CMS plans to review the state submitted tax and waiver materials, looking at each tax-rate group, the entities in those groups and the Medicaid and non-Medicaid units tied to them. No single factor will automatically prove a group was designed to target Medicaid, but multiple overlapping features that point to Medicaid use, even without naming Medicaid, will trigger closer examination.

Permissible Health Care-Related Taxes—Transition Period

In contrast to the Proposed Rule, CMS finalized more flexible transition periods requiring states with taxes that do not follow the generally redistributive requirement to follow the timelines set by the OBBBA.[8] The transition period for health care taxes to remain permissible will start from the Final Rule's April 3, 2026 effective date until the specific deadline for a state to modify or discontinue any health care tax waiver that fails to meet the new requirements. Under the Final Rule, the transition periods include the following timeframes, which are also shown in Table 1 below:

- Health care-related taxes on Managed Care Organization (MCO) services that are generally not redistributive and were approved by CMS between April 3, 2024 and April 3, 2026 (the Final Rule's effective date) have a transition period ending on December 31, 2026. This makes the compliance date January 1, 2027.
- Non-redistributive MCO taxes approved by CMS more than two years before April 3, 2026, must comply by the state's 2028 fiscal year (FY) and their transition period ends the day before the first state fiscal year that begins at least one year after April 3, 2026. The exact dates vary by state.
- Health care-related taxes on all services other than MCO services that are generally not redistributive have a transition period of the final day of the state FY that ends in calendar year 2028, but no later than September 30, 2028.

Table 1. Compliance Dates Based on Transition Periods for OBBBA and this Final Rule

Tax Permissible Class	Most Recent Waiver Approval	Compliance Date
MCO tax	2 years or less	January 1, 2027
MCO tax	More than 2 years	State Fiscal Year 2028
Non-MCO tax	Any length of time	State Fiscal Year 2029

Before the designated transition period ends, the affected states have two options to comply with the Final Rule. CMS notes that states may submit a waiver for a genuinely redistributive tax that satisfies the statistical tests and the new Final Rule requirements. States may also restructure the tax to meet the broad-based and uniformity rules so that a waiver is not required. CMS plans to offer technical assistance to states likely affected to ensure awareness of requirements and timeframes and will monitor whether affected taxes are amended if no new waiver is submitted.

Codifying the Generally Redistributive Requirement from One Big Beautiful Bill Act

CMS finalized updates to existing regulations which specify the circumstances in which a health care-related tax would not be considered generally redistributive and includes timeframes for states

[8] The OBBBA was signed into law after the Proposed Rule was released, https://www.congress.gov/bill/119th-congress/house-bill/1/text

to comply with these new requirements.[9,10] These updates also align with the new statutory requirements enacted in Section 71117 of OBBBA, so additional rulemaking to implement this section of the law is not anticipated.[11]

What's Next?

The regulations are effective April 3, 2026. However, CMS provides transition timelines for states to change their provider taxes, if needed. Vizient's Office of Public Policy and Government Relations is available to answer questions about provisions in the Final Rule. Please reach out to Randi Gold, Director, Hospital Payment Policy and Regulatory Affairs in Vizient's Washington, D.C. office.

[9] Under § 433.68(e) Permissible health care-related taxes. Available at: eCFR :: 42 CFR 433.68 -- Permissible health care-related taxes.
[10] Section 71117 of the OBBBA, available at: https://www.congress.gov/bill/119th-congress/house-bill/1/text
[11] Congress enacted OBBBA on July 4, 2025 and because the statutory changes are substantively identical to the Final Rule language, CMS determined that an additional notice-and-comment period is unnecessary, and finalized the policies outlined above to implement the statutory requirements.