Fact Sheet on Medicaid Managed Care Organization (MCO) Sales Tax

Background on Medicaid MCO sales tax – What is it?

Current law provides that effective October 1, 2009 "all transactions by which health care services are paid for, reimbursed, provided, delivered, arranged for, or otherwise made available by a Medicaid health insuring corporation pursuant to the corporation's contract with the state" is subject to both state and local sales and use taxes collected by the Department of Taxation (ORC 5739.01 (B) (11) (a)).

For purposes of collecting the tax, the MCO is considered the consumer of the service. The state and local sales taxes are collected by the state and the local portion is remitted to the county or transit authority. For purposes of applying local sales taxes, the state credits the local sales tax to the county of residence of the MCO enrollee.

Brief history of MCO sales tax

Federal law permits states to impose taxes on a number of classes of health care items and services without affecting federal Medicaid matching funding. Ohio currently administers a 2.7 percent hospital franchise fee, 5.5 percent nursing facility franchise fee, and a 1 percent health insuring corporation (HIC) tax, each of which is permissible according to the federal government. Significant events leading up to the present situation include the following:

- From 2005 to 2009, Ohio collected a 5.5 percent Medicaid MCO franchise tax in addition to the 1.0 percent HIC tax.
- The federal Deficit Reduction Act of 2005 broadened the federal definition of permissible classes to include all MCO's, not just Medicaid MCO's. The Medicaid MCO franchise tax was determined to be an impermissible tax which the state needed to replace with another funding mechanism.
- Ohio repealed the Medicaid MCO franchise tax in September 2009, and replaced the lost revenue by applying the 5.5 percent state sales tax and local sales taxes to services purchased by Medicaid MCO's. The state projected a significant increase in local sales tax revenue due to the application of local sales taxes to Medicaid MCO transactions. The SFY 10 – 11 budget (HB 1) "carved out" the MCO pharmacy program to increase Medicaid drug rebate revenue and thus these transactions were not subject to the sales tax.
- With the adoption of SFY 2012 – 2013 state budget (HB 153), Medicaid pharmacy benefits were incorporated within the scope of services subject to state and local sales taxes. This sales tax base broadening would increase state and local sales tax revenue.
- The Executive version of SFY 2014 – 2015 state budget (HB 59) originally included provisions expanding Medicaid under the Affordable Care Act. This provision was removed by the legislature, but the Controlling Board approved expansion of the Medicaid program utilizing provisions of the federal Affordable Care Act effective January 1, 2014. The additional sales tax base broadening was to increase again state and local sales tax revenue.

Why does the Federal Government have an issue with MCO sales tax and when might it become a problem?

The Center for Medicare and Medicaid Services (CMS) has voiced concerns for some time about the use of these types of taxes to boost Medicaid drawdown and in 2014 sent a letter asserting that because of changes made in the Deficit Reduction Act of 2005, states who apply sales tax to Medicaid managed care organizations (MCOs), but not to other health maintenance organizations are violating federal rules. CMS advised Ohio to "make any changes necessary to achieve compliance as soon as feasible, but no later than the end of their next regular legislative session". Further conversations have deduced that the timeline to either fix the tax or turn it off should happen by the end of the next state budget cycle, which would be July 2017. CMS has further instructed that In order to come into compliance Ohio's tax must:

(1) Be broad based and apply to all services within each permitted class as defined in federal law;

(2) Be uniform, so that all payers of the tax pay at the same rate; and

(3) Reimbursement rates cannot create a "hold harmless" situation in which taxes are returned directly or indirectly to the providers, unless they amount to less than 6 percent of the revenues to the provider class.

How big a problem could it be?

The Department of Taxation and the Office of Budget and Management have calculated the level of reliance of counties and transit authorities on the Medicaid MCO sales tax at approximately $145,000,000 for counties and $35,000,000 for transit authorities in SFY 2015 (July 2014 to June 30, 2015).

CCAO is in conversations with the Ohio Office of Budget and Management to gather information on the impact of the possible loss of the state sales tax on Medicaid MCO's to the state General Fund and also the potential impact of this problem on the ability of the state to match and draw down federal Medicaid dollars to provide services to Medicaid service providers. These conversations are ongoing and CCAO will be sharing this information as more information becomes available.

Next Steps

CCAO will be having meetings throughout the summer and fall with members of the Administration and the General Assembly to explore possible solutions aimed at protecting counties and the states from financial and service delivery problems associated with the potential loss of revenue with the Medicaid MCO sales tax. Additionally, NACo and other state associations are providing CCAO with information about how other states confronted with this same compliance challenge have addressed it.