DEPARTMENT OF HEALTH & HUMAN SERVICES

Health Care Financing Administration

The Administrator
Washington, D.C. 20201

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TO: Carol Rasco
Assistant to the President for
Domestic Policy

FROM: Bruce C. Vladeck
Through: Kevin Thurm

SUBJECT: Donations and Taxes Statute Enforcement

In the very near future, we intend to set up meetings with six states to discuss the exact amount of Federal money we believe was wrongly paid to them as Federal match to State funds raised through impermissible provider taxes. This will begin the disallowance process.

Background: The Statute
Public Law 102-234, the Donations and Taxes Statute, was enacted by Congress in 1991. It was designed to end financing schemes which improperly enhanced the Federal matching rate for State Medicaid programs. In the early days of the Clinton Administration, the Health Care Financing Administration (HCFA) worked very closely with the States to develop the regulations to implement the statute. The basic requirements of the statute are described in Attachment A.

If a tax does not meet the statutory/regulatory requirements, HCFA has the authority to recover related monies paid to the State. Specifically, the State's total amount of Medicaid expenditure shall be reduced by the sum of any revenues received by the State from impermissible provider taxes or donations, before any Federal matching funds are calculated.

Background: Enforcement
You may recall that last year, as part of our enforcement of the statute, HCFA identified States with health care-related taxes which we believed might be in violation of the law. These taxes fell into three categories: 1.) those which seemed clearly impermissible; 2.) those which might be permissible if the State received a waiver; and 3.) those about which we needed more information in order to determine their legality.

On December 19, 1994, HCFA sent letters to the nine States with taxes that seemed clearly impermissible, informing them that they maintained a health care-related tax program which appeared to violate the law. In these letters, we indicated the estimated tax revenue associated with each of the impermissible tax programs. In addition, we indicated the estimated Federal financial participation associated with the impermissible tax programs. We have now received responses from each of the nine States concerning the impermissible health care-related tax programs.

Progress in Three States

Two of the States have come into compliance with the law, and there is no need to take further action. The State of Alabama's impermissible tax program expired prior to the end of its transition period. Alabama did not collect any revenues associated with the impermissible tax program beyond its transition period, so the State owes the Federal government no money. The State of Nevada has already reduced its Medicaid expenditures for the impermissible tax revenues collected beyond its transition period (approximately $500,000).

The State of Arkansas has been in consistent communication with HCFA's Dallas Regional Office (with whom they have a good relationship) on this issue. They have already been informed that we estimate that they owe us $2 million in federal payments which matched impermissible taxes.

The Remaining Six States

The remaining six States were unable to provide additional information to change HCFA's opinion on the permissibility of their health care-related tax programs. Consequently, for these six states, we must now verify the actual tax revenues associated with the impermissible health care-related tax programs in order to begin the disallowance process.

We will send letters to these six States to notify them that HCFA continues to consider the health care-related tax programs impermissible and that a meeting will be scheduled with the State to determine the actual tax revenue associated with each impermissible tax program. We believe that when States receive these letters, they may contact the White House to complain (States already have a general idea of how much they owe the Federal government).

Once we hold this initial meeting, we will write to each State, explaining why their tax is impermissible and the amount of money we intend to disallow. The State then has the opportunity to counter our arguments. The entire disallowance process takes about six months or a little longer. We will ask for repayment of the disallowed money in a short but reasonable timeframe. After the process is completed, States can appeal HCFA's decision through the Departmental Appeals Board (DAB), and later through the court system. The Office of General Counsel has told us that States could petition to keep their money during the DAB process, as long as the State agreed to repay the money with interest if they lose the case. If the State lost the case and appealed to a district court, it could try to get an injunction to stop the collection of the disallowed sum during the court process.

Attachment B shows each State's tax program, the time period involved, the estimated tax revenue, and the amount of FFP. Although the attached chart reflects impermissible tax revenue collected as of June 30, 1994, we will verify and take action on actual impermissible tax revenue collected up to the date on which we take action.

It is worth noting that two of the States, Louisiana and Tennessee, are States to which we are currently providing technical assistance because these States are having trouble funding their Medicaid programs. However, these two States have been aware for a while that their taxes were likely to be found impermissible. In addition, we think it is important that Louisiana and Tennessee be fully alerted to impending fiscal problems which would result from our disallowance.

Attachments

Attachment A

In general, there are four requirements that a health care related tax must meet in order to be permissible:

1. it must tax a class of items and services listed in the statute or designated by the Secretary in regulations;

2. the tax must be broad-based; i.e., it must tax all of the items or services or providers of those services, in a class;

3. the tax must be uniformly applied. The statute lists three specific kinds of taxes that are uniform, and permits the Secretary to determine that other kinds of taxes are also uniform; and

4. a tax may not hold taxpayers harmless for their tax payments.

According to the statute and regulations, States are not permitted to hold providers harmless directly through guarantees or other explicit repayment arrangements. In addition, States are not permitted to hold providers harmless indirectly through Medicaid payments. HCFA will consider a hold harmless provision to exist if the tax is applied at a rate in excess of 6 percent of provider revenue and more than 75 percent of providers receive more than 75 percent of their tax costs through Medicaid rate increases and other State payments (75/75 test). The regulations allow States until September 13, 1993 to revise a tax in excess of 6 percent that could not meet the 75/75 test. If the tax was not modified, funds received by the State on/or after September 13, 1993 will be disallowed.

ATTACHMENT B

	STATE	TIME PERIOD	ESTIMATED TAX REVENUE	ESTIMATED FFP
1.	ARKANSAS	07/01/93-06/30/94	$ 4,000,804	$ 2,113,131
	Personal Care Tax			
2.	HAWAII	10/01/92-06/30/94	$ 22,009,948	$ 11,004,974
	NF Revenue Tax			
3.	ILLINOIS	10/01/92-06/30/94	$223,621,000	$111,820,000
	NF Bed Tax			
4.	LOUISIANA	10/01/92-06/30/94	$152,623,867	$112,475,280
	NF Bed Tax			
5.	MAINE	07/01/93-06/30/94	$ 10,500,000	$ 6,500,000
	NF Gross Receipts Tax			
6.	NEVADA	07/01/93-06/30/94	$ 1,087,459	$ 547,101
	Hospital Tax			
7.	NEW YORK	10/01/92-06/30/94	$ 26,275,000	$ 13,137,500
	Personal Care Tax			
	Mental Retardation Day Treatment Tax(es)			
	Gross Receipts Tax On Laboratories Within Hospitals			
8.	TENNESSEE	10/01/92-06/30/94	$179,081,591	$120,714,142
	NF Bed Tax			