Legislative Analysis

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MODIFY AND REINSTITUTE MEDICAID MCO USE TAX; ACCELERATE HICA SUNSET

As Passed by the House

Senate Bill 987 (H-1)
Sponsor: Sen. Ken Horn

Senate Bill 988 (H-2)
Sponsor: Sen. Jim Stamas

Senate Bill 989 (H-1)
Sponsor: Sen. Peter MacGregor

Senate Bill 990 (H-1)
Sponsor: Sen. Mike Shirkey

House Committee: Insurance
Senate Committee: Michigan Competitiveness

Complete to 9-23-16

SUMMARY:

These bills would reinstitute the state's Use Tax on Medicaid Managed Care Organizations (MCOs) but earmark the proceeds for non-Medicaid purposes, earmark current GF/GP revenue for Medicaid purposes, and accelerate the sunset on the Health Insurance Claims Assessment (HICA).

Compared to estimated state resources under current law:

- If the plan contained in the package is not disapproved by the federal government and is fully implemented, it would increase net state resources by an estimated $109 million in FY 2016-17, $145 million in FY 2017-18, $146 million in FY 2018-19, and $231 million in FY 2019-20.
- If, on the other hand, the plan is disapproved by the federal government, it would reduce net state resources by $258 million in FY 2018-19 and $263 million in FY 2019-20.

While the House Fiscal Agency cannot make a definitive statement regarding the likelihood of federal disapproval of the plan, it does appear that current federal law could be interpreted in a way that would effectively result in federal disapproval. The relevant federal law is described later in this analysis.

SUMMARY OF THE BILLS:

Senate Bill 989 would amend the Use Tax Act to specify that beginning January 1, 2017 the state share of the Use Tax on Medicaid MCOs would be deposited into a newly created Health Services Fund. The State Constitution requires one-third of Use Tax revenues to be distributed to the School Aid Fund, so this bill would not change that distribution.

Currently, the proceeds from taxing Medicaid MCOs are distributed to the state's General and School Aid Funds, consistent with other Use Tax revenue.

Senate Bill 988 would amend the Michigan Trust Fund Act to create a new Health Services Fund. Money would be expended from the fund, upon appropriation, for the following, in descending order of priority:

- $2.0 million per fiscal year to the Safe Drinking Water Revolving Fund created under the Natural Resources and Environmental Protection Act, for assisting qualified water suppliers in satisfying the requirements of the federal Safe Drinking Water Act and for the distribution of low-interest loans and grants to qualified water suppliers. (For FY 2016-17, $2.1 million GF/GP is appropriated for such services.)
- $100.0 million for community mental health (CMH) non-Medicaid services. At least 5% of those funds would be required to be used to support statewide adverse childhood experience intervention services. (For FY 2016-17, $120.1 million GF/GP is appropriated for CMH non-Medicaid services.)
- $30.0 million for local public health for non-Medicaid services. (For FY 2016-17, $35.7 million GF/GP is appropriated for essential local public health services.)
- $204.0 million for the Federal Medicare Pharmaceutical Program, except that for FY 2016-17 only, $150.0 million would be distributed for that purpose. (For FY 2016-17, $249.2 million GF/GP is appropriated for this program, which is the "clawback" for state pharmaceutical costs prior to the creation of Medicare Part D.)
- Any remaining funds would be distributed to the Department of Corrections for clinical and mental health services. (For FY 2016-17, roughly $300 million GF/GP is appropriated for those services.)

This analysis assumes that revenue in the Health Services Fund would be used to offset current GF/GP appropriations for the purposes above on a one-for-one basis.

The bill contains a prohibition on the use of money deposited in the Health Services Fund for the Medicaid program, the state's Medical Services Administration, or the Healthy Michigan Plan. This prohibition is also contained in Senate Bill 989.

Senate Bill 990 would amend the Income Tax Act of 1967 to earmark, beginning January 1, 2017, income tax revenue currently available for GF/GP appropriations to instead be deposited into the state's Medicaid Benefits Trust Fund. This earmark would support the state's Medicaid program through maintaining actuarially sound rates for Medicaid MCOs. The amount of the earmark would be equal to two-thirds of the immediately preceding calendar year's collections from the Medicaid MCO Use Tax.

Senate Bill 987 would amend the Health Insurance Claims Assessment Act, beginning January 1, 2017, to reduce HICA to 0.0% with the condition that HICA would be assessed at 1.0% "if the federal government provides a written notification and explanation" to the state that the federal government will reduce federal Medicaid matching funds as a result of the state assessing the Medicaid MCO Use Tax and the state has exhausted all waivers

and appeals. HICA would also be assessed at 1.0% if the federal Medicaid matching funds provided to the state are actually reduced due to the Medicaid MCO Use Tax.

The bill would also amend the Health Insurance Claims Assessment Act to effectively move the sunset date for the assessment up from July 1, 2020, to December 31, 2018.[1] This bill also includes an enacting section to repeal the Health Insurance Claims Assessment Act effective January 1, 2019.

The four bills are all tie-barred to one another.

BACKGROUND INFORMATION:

Medicaid Financing

Medicaid is a joint federal-state health care safety net program. The traditional Medicaid program provides physical and mental health coverage to approximately 1.7 million individuals in the state—generally pregnant women, parents and children, and the aged, blind, and disabled, with incomes below varying thresholds. For FY 2016-17, the traditional Medicaid program is funded at a match rate of 65.15% federal and 34.85% state.

The expanded Medicaid program under the Healthy Michigan Plan provides coverage to approximately 600,000 additional adults at up to 138% of the federal poverty level and is currently funded 100% by the federal government. This match rate will drop to 95% effective January 1, 2017 and will continue to phase down until it reaches 90% in 2020.

The FY 2016-17 Medicaid budget totals $16.7 billion. Of that total, $12.1 billion is funded by the federal government, and the remaining $4.6 billion consists of state match funds. The largest portion of those state match funds are GF/GP funds ($2.5 billion), but Michigan has implemented a number of restricted financing mechanisms to reduce state GF/GP funding requirements and to boost reimbursement rates for Medicaid providers.

These restricted funding sources include provider assessments levied on hospital and nursing home receipts under the state's Qualified Assurance Assessment Program (QAAP), the Medicaid Benefits Trust Fund (which receives revenue primarily from cigarette tax revenue), the Health Insurance Claims Assessment, special financing funds claimed against contributions from public and university hospitals, and the Merit Award Trust Fund (which receives revenue from the state's share of tobacco settlement revenue). Restricted funds appropriated for total Medicaid costs from these and other smaller sources total $2.1 billion.[2]

[1] Public Act 50 of 2016 (House Bill 5105), which will take effect 91 days after adjournment of the 2016 legislative session, extends the sunset from the current date of December 31, 2017, to July 1, 2020.

[2] For additional background information on the state's Medicaid program, and the factors allowing for effective flat GF/GP appropriations for the program over the last 15 years, see this October 2015 HFA report: http://www.house.mi.gov/hfa/PDF/CommunityHealth/Michigan_Medicaid_Program_Oct2015.pdf.

History of Federal and State Changes Related to Medicaid Financing

The process by which the federal government provides Medicaid match funds to states is outlined in Section 1903 of the federal Social Security Act. In general, any state payments for medical assistance approved under the state's Medicaid State Plan are eligible for federal reimbursement (typically at the state's Federal Medical Assistance Percentage [FMAP]). The Medicaid Voluntary Contribution and Provider-Specific Tax Amendments of 1991 (PL 102-234) did however add subsection (w) to Section 1903 requiring federal financial participation to be reduced based on any impermissible provider-related donation or health care-related tax received by that state.

Specific to health care-related taxes, a permissible tax must meet three criteria:

- The tax must be broad based with respect to all items or services in a provider class.
- The tax must be uniformly imposed through the state.
- The tax cannot have a hold harmless provision.

The act included separate provider classes for hospital services, nursing facilities, physician services, services of *health maintenance organizations* (HMOs), among others. The act does permit states to request a waiver, under certain conditions, if the tax is not broad based or imposed uniformly.

Over the last two decades, various federal and state actions have resulted in frequent changes in Michigan's use of assessments from managed care organizations (MCOs) and other health insurers as a Medicaid financing tool, as outlined below.[3] To comply with the federal requirement that Medicaid managed care rates be actuarially sound, the state has reimbursed Medicaid MCOs for the costs related to each of these assessments. Because these reimbursements are financed with both state and federal funds, the revenue received under the assessments has exceeded the state-funded reimbursement costs, creating a net benefit to the state.

Creation of Medicaid MCO QAAP

The federal Balanced Budget Act of 1997 (PL 105-33) replaced the health maintenance organization provider class with the term *Medicaid managed care organizations*, effectively allowing a tax on only Medicaid managed care, rather than all managed care, to qualify as a broad based, permissible health care-related tax. As a result many states implemented a Medicaid-only MCO tax.

In Michigan, Senate Bill 748 (2002 PA 304), amended by House Bill 6327 (2002 PA 621), created a Quality Assurance Assessment Program (QAAP) on Medicaid MCOs based in part on the argument that Medicaid reimbursements were lagging behind medical inflation and medical providers were finding it too costly to accept Medicaid beneficiaries. The Medicaid MCO QAAP and any associated federal financial participation were used to supplement GF/GP-funded Medicaid payments

[3] The term "managed care organization" includes both traditional HMOs and Prepaid Inpatient Health Plans (PIHPs), through which Medicaid mental health services are funded.

to ameliorate these concerns. In FY 2007-08 (the last full fiscal year with MCO QAAP) $263 million in Medicaid MCO QAAP was assessed, resulting in a net provider benefit of $154 million and a state retainer benefit of $88 million.[4]

Shift to Medicaid MCO Use Tax

The federal Deficit Reduction Act of 2005 (PL 109-171) replaced the Medicaid managed care organization provider class with the term *managed care organizations* and required states with Medicaid-only MCO taxes to revise or replace those impermissible health care-related taxes by October 1, 2009.

Michigan responded with House Bill 5192 (2008 PA 440), which repealed the Medicaid MCO QAAP and instead made medical services provided by Medicaid MCOs subject to the 6% Use Tax beginning April 1, 2009. In FY 2010-11 (the last full fiscal year with this iteration of the MCO Use Tax), the Medicaid MCO Use Tax generated $383 million in revenues. These revenues allowed the state to continue providing Medicaid MCOs with comparable reimbursement rates to the rates provided with the repealed Medicaid MCO QAAP without having to utilize state funds from other sources or tax non-Medicaid MCO receipts.

Shift to Health Insurance Claims Assessment

In 2011, the Governor became concerned that the federal government intended to declare that the Medicaid MCO Use Tax was not a permissible health care-related tax. Eight states faced possible federal action: California, Georgia, Kentucky, Michigan, Missouri, Ohio, Oregon, and Pennsylvania. Rather than risking the loss of federal Medicaid revenue, the Governor proposed an alternate approach: the Health Insurance Claims Assessment (HICA).

Senate Bill 347 (2011 PA 141) sunset the MCO Use Tax beginning April 1, 2012 and Senate Bill 348 (2011 PA 142) created HICA beginning January 1, 2012. HICA applies, with certain exceptions, to all health insurance claims in the state, including both Medicaid-funded claims and privately-funded claims. Initial forecasts assumed a 1.0% HICA would generate between $375 million to $400 million in revenues. However, actual HICA revenues were closer to $270 million, requiring the state to identify other resources to keep the Medicaid program whole.[5] The FY 2011-12 budget relied on GF/GP lapses, the FY 2012-13 budget relied on restricted revenue fund balances, and in FY 2013-14 the state reinstituted the Medicaid MCO Use Tax.

Reinstatement of Medicaid MCO Use Tax

Senate Bill 893 (2014 PA 161) reinstated the 6% Medicaid MCO Use Tax effective on April 1, 2014 and Senate Bill 913 (2014 PA 162) reduced HICA from 1.0% to

[4] The net provider benefit is the amount of supplemental payments, including federal financial participation, less assessed MCO QAAP. QAAPs also include some portion of state retainer used to offset GF/GP.

[5] The gap between the original estimate and actual collections was due to several factors, including out-of-state policies being larger than expected and an under-estimation of the impact of increasing health care deductibles and co-pays (which are not taxed).

0.75% beginning July 1, 2014. In the Centers for Medicare & Medicaid Services (CMS) approval letter dated September 25, 2014 for these public acts, CMS noted its concern with the Medicaid MCO Use Tax: "Consistent with the guidance in the State Health Official letter [14-001, issued July 25, 2014], CMS reminds the State that in order to comply with the requirements, the tax will need to be sunset by the end date of the State's next legislative session or by 12/31/15." December 2016 is the end date that applies to Michigan.

Under the FY 2016-17 enacted budget assumptions, the Medicaid MCO Use Tax will not be collected after December 31, 2016 and the HICA rate will automatically increase from 0.75% to 1.0% under current law. While the increase in the HICA rate will partially offset the loss of Use Tax revenue, a net increase of approximately $140 million per year in regular GF/GP funds are needed to maintain the Medicaid program. Additionally, the School Aid Fund will experience a loss of approximately $200 million per year. Since these changes occur on a calendar year basis, the enacted FY 2016-17 budget had to account for roughly three-quarters of these changes.

Potential Federal Action Regarding Senate Package

Senate Bills 987 through 990 represent an attempt to create another iteration of a Medicaid MCO financing mechanism, by earmarking the Medicaid MCO use tax revenue for non-Medicaid purposes and creating a net gain to the state, which allows for the repeal of HICA. Whether the federal government would ultimately disapprove this plan is an open question. Consistent with previous Medicaid MCO financing mechanisms, the state would need to receive federal approval to reimburse MCOs for the costs of the reinstituted Use Tax with federal match funds.

As stated above, federal regulations require that a health care-related tax meet the following requirements:

- The tax must be broad based with respect to all items or services in a provider class.
- The tax must be uniformly imposed through the state.
- The tax cannot have a hold harmless provision.[6]

Because it is not levied on all MCOs, Michigan's Use Tax on Medicaid MCOs is not broad based, and therefore does not meet the federal definition of a permissible health care-related tax. The key question is whether the federal government would determine that this requirement applies to a tax that is not directly utilized for state Medicaid costs. Federal law is not explicit on that matter. If the requirement does apply, the federal government could reduce federal Medicaid reimbursement to the state based on this modified version of the Use Tax mechanism, effectively disapproving the plan.

[6] See 42 CFR 433.55, 433.68, and 433.70 for all provisions related to health care-related taxes: http://www.ecfr.gov/cgi-bin/text-idx?SID=ffba6393b5f8ff3fb23750c932dec08f&mc=true&tpl=/ecfrbrowse/Title42/42cfr433_main_02.tpl.

Recent California Action

Historically, California has followed a similar path to Michigan's in terms of managed care-related Medicaid financing. Facing the same discontinuation of its tax on Medicaid MCOs, the state recently adopted a modified version of their MCO tax that has received federal waiver approval.[7] California's modified MCO tax fundamentally differs from the plan contained in Senate Bills 987 through 990, however, in that nearly all MCOs in the state would pay the tax, albeit with a tiered structure and offsetting reductions in other taxes paid by health insurers. These differences helped California's modified MCO tax meet the statistical tests outlined in federal regulations for waiving the uniformity and broad-based requirements, as the federal government found California's modified MCO tax to be "generally redistributive".[8]

FISCAL IMPACT:

The impact of the Senate package on the state budget would depend on whether or not the federal government ultimately disapproves of this new financing arrangement. The timing of any federal guidance cannot be known ahead of time. The tables below assume that guidance would be received prior to January 1, 2017, when the major changes in the package would take effect.

If the Plan is Not Disapproved by the Federal Government

Assuming the plan is fully implemented as described in the legislation, the bills would provide a net increase in state resources, as shown below:

Estimated Increase/(Decrease) in State Resources
Assuming Federal Government Does Not Disapprove Financing Plan
Compared to Current Law
Millions of $

	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20
MCO Use Tax to Health Services Fund (offsets GF/GP)	324	438	447	456
MCO Use Tax to School Aid Fund	162	219	223	228
GF/GP Cost to Replace Foregone HICA Revenue	(250)	(337)	(343)	(263)
GF/GP Cost for Medicaid Actuarial Soundness for MCO Use Tax	(127)	(176)	(181)	(190)
Total Net Increase/(Decrease) in State Resources	**109**	**145**	**146**	**231**

[7] Sacramento Bee articles on the modified tax and federal approval:
http://www.sacbee.com/news/politics-government/capitol-alert/article63206847.html
http://www.sacbee.com/news/politics-government/capitol-alert/article78186892.html

[8] Federal approval letter: http://www.dhcs.ca.gov/services/medi-cal/Documents/CAMCOTaxlett51716.pdf

The Health Services Fund revenues would be used to offset GF/GP currently appropriated for the programs and services listed in Senate Bill 988. Those freed up GF/GP revenues would permit the state to deposit two-thirds (i.e. the GF/GP portion) of the preceding calendar year's MCO Use Tax revenues into the Medicaid Benefits Trust Fund for the purpose of maintaining actuarially sound rates for Medicaid MCOs. The Medicaid Benefits Trust Fund revenues not needed to support the actuarial soundness of the MCO Use Tax would be used to offset GF/GP within the Medicaid program.

After all of the transfers, offsets, and payments, net GF/GP-equivalent resources would be reduced by an estimated $53 million in FY 2016-17, $74 million in FY 2017-18, and $78 million in FY 2018-19. Net GF/GP resources would increase by $3 million in FY 2019-20.

School Aid Fund revenues would increase by an estimated $162 million in FY 2016-17, $219 million in FY 2017-18, $223 million in FY 2018-19, and $228 million in FY 2019-20.

If the Plan is Disapproved by the Federal Government

If the plan is disapproved by the federal government, this analysis assumes the state would not collect the MCO Use Tax and would not have to pay the associated Medicaid actuarial soundness. The bills would still accelerate the HICA sunset date from July 1, 2020 to December 31, 2018, requiring GF/GP funds to offset HICA revenues in FY 2018-19 and FY 2019-20, as shown below. There would be no impact to the School Aid Fund.

Estimated Increase/(Decrease) in State Resources
Assuming Federal Government Disapproves Financing Plan
Compared to Current Law
Millions of $

	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20
MCO Use Tax to Health Services Fund (offsets GF/GP)	0	0	0	0
MCO Use Tax to School Aid Fund	0	0	0	0
GF/GP Cost to Replace Foregone HICA Revenue	0	0	(258)	(263)
GF/GP Cost for Medicaid Actuarial Soundness for MCO Use Tax	0	0	0	0
Total Net Increase/(Decrease) in State Resources	**0**	**0**	**(258)**	**(263)**

If the Plan is Disapproved After January 1, 2017

Under a scenario where the federal government has neither explicitly approved nor disapproved the proposed financing plan as of January 1, 2017, then the HICA rate would effectively be reduced from 1.0% to 0.0% under the provisions of Senate Bill 987 and the state would collect the Medicaid MCO Use Tax after January 1, 2017. If the federal

government subsequently disapproves it, then the state could face a reduction in federal Medicaid reimbursement of approximately $125 million for each quarter the Medicaid MCO Use Tax is collected, in addition to the HICA revenue loss described in the tables above.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.