



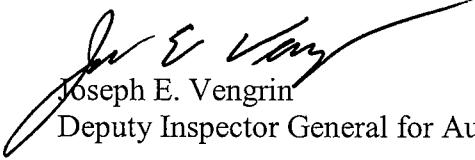
DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

MAR 22 2007

TO: Leslie V. Norwalk, Esq.
Acting Administrator
Centers for Medicare & Medicaid Services

FROM: 
Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: Review of Missouri Provider Tax (A-07-06-01029)

Attached is an advance copy of our final report on the State of Missouri's use of a health care-related tax (provider tax) to help finance its share of the Medicaid program. A State may use a provider tax as the State share of Medicaid expenditures to obtain Federal financial participation (FFP). We will issue this report to the Department of Social Services within 5 business days.

In 2002, Missouri and the Centers for Medicare & Medicaid Services (CMS) negotiated an agreement, the Medicaid Partnership Plan, to establish a stable funding mechanism for the State's Medicaid program. For State fiscal year (FY) 2004, Missouri taxed 131 hospitals and used provider taxes of \$552 million as its State share to obtain \$997 million in FFP.

Our objective was to determine whether Missouri's provider tax for State FY 2004 complied with the requirements for obtaining FFP outlined in Federal laws and regulations and the Medicaid Partnership Plan.

Our review found that Missouri's provider tax for State FY 2004 did not comply with the requirements for a permissible provider tax outlined in Federal laws and regulations and the Medicaid Partnership Plan. Missouri did not have policies and procedures to ensure that its provider tax program complied with Federal laws and regulations and the plan. As a result, Missouri's provider tax may have been impermissible.

The Medicaid Partnership Plan required Missouri to alert CMS to any changes to the State funding source. However, Missouri failed to notify CMS of material changes that it made to the terms of the provider tax. Missouri modified both the tax basis and tax rate without allowing CMS to review the changes before implementing the provider tax.

In addition, even though Missouri asserted to CMS as part of the implementation of the Medicaid Partnership Plan that it had complied with the requirements of

42 CFR § 433.68(e)(2)(i), Missouri did not perform the required separate waiver tests on all classes of service taxed to demonstrate that the provider tax was permissible.

For 27 hospitals we reviewed, Missouri incorrectly taxed items or services (such as office rental income, interest earned, and cafeteria revenue) that are not included in the classes of health care items or services enumerated in the regulation. Missouri also incorrectly included the revenue from these taxes in the waiver test. Section 1903(w)(3)(B) of the Social Security Act requires that provider taxes be imposed only on specified health care items or services to be permissible. Therefore, portions of Missouri's provider tax are impermissible and require a reduction in FFP.

Because Missouri materially changed the terms of the provider tax without notifying CMS and did not complete the waiver tests in accordance with Federal regulations and the Medicaid Partnership Plan, we could not determine whether the tax was generally redistributive in accordance with Federal regulations and the plan. In addition, because portions of the provider tax were impermissible, Missouri obtained \$8 million of unallowable Federal reimbursement based on the 27 hospitals we reviewed.

We recommend that Missouri:

- submit to CMS a separate waiver test for each class of service for State FY 2004,
- refund \$8,235,595 to the Federal Government,
- submit to CMS a separate waiver test for each class of service for State FYs 2005 and 2006,
- refund Federal reimbursement for the unallowable tax amounts paid by the hospitals not included in our audit and for unallowable Federal reimbursement for State FYs 2005 and 2006,
- notify CMS of any State changes to the provider tax program, and
- develop policies and procedures to ensure that the provider tax program complies with all Federal and negotiated requirements for provider taxes when completing the waiver tests.

In written comments on our draft report, Missouri did not agree with the findings or the recommendations. After reviewing Missouri's comments, we continue to believe that the provider tax as implemented did not comply with Federal laws and regulations and the Medicaid Partnership Plan. Because Missouri signed the Medicaid Partnership Plan with CMS, the State is bound by the provisions of the document, among which is the mandate that Missouri's tax structure comply with the laws and regulations governing the Medicaid program. Moreover, Missouri did not correctly interpret or comply with the requirements for a permissible provider tax.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at George.Reeb@oig.hhs.gov or Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591, extension 274, or through e-mail at Patrick.Cogley@oig.hhs.gov. Please refer to report number A-07-06-01029 in all correspondence.

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

MAR 23 2007

Report Number: A-07-06-01029

Ms. Deborah E. Scott
Director
Department of Social Services
Broadway State Office Building
P.O. Box 1527
Jefferson City, Missouri 65102

Dear Ms. Scott:

Enclosed are two copies of the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG) final report entitled "Review of Missouri Provider Tax." A copy of this report will be forwarded to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. § 552, as amended by Public Law 104-231), OIG reports issued to the Department's grantees and contractors are made available to the public to the extent the information is not subject to exemptions in the Act that the Department chooses to exercise (see 45 CFR part 5).

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, extension 274, or contact Chris Bresette, Audit Manager, at (816) 426-3591, extension 228, or through e-mail at Chris.Bresette@oig.hhs.gov. Please refer to report number A-07-06-01029 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosures

Direct Reply to HHS Action Official:

Mr. Thomas Lenz
Regional Administrator
Centers for Medicare & Medicaid Services, Region VII
Richard Bolling Federal Building
601 East 12th Street, Room 227
Kansas City, Missouri 64106

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF MISSOURI
PROVIDER TAX**



Daniel R. Levinson
Inspector General

March 2007
A-07-06-01029

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.



EXECUTIVE SUMMARY

BACKGROUND

Federal Medicaid Regulations

Title XIX of the Social Security Act authorizes Federal grants to States for Medicaid programs to provide medical assistance to persons with limited incomes and resources. The States administer the Medicaid program in accordance with Federal laws and regulations. The Federal Government, through the Centers for Medicare & Medicaid Services (CMS), and the States share in the cost of the program. The Federal share of Medicaid program expenditures is known as Federal financial participation (FFP).

States may assess a health care-related tax (provider tax) to help finance their share of the Medicaid program. A State may use the provider tax as the State share of Medicaid expenditures to obtain FFP.

Permissible provider taxes must be broad based and uniform. To be broad based, a provider tax must be imposed on all health care items or services or on all providers of such items or services within a class of health care items or services. Federal regulations specify 19 classes of health care items or services, such as inpatient, home health, and therapy services. To be uniform, a provider tax must be imposed at a uniform rate on all items or services within a class.

States may obtain a waiver from the broad-based and uniformity requirements. To obtain a waiver, Federal regulations require States to perform a specific waiver test for each class of health care item or service that the State taxes. The purpose of the waiver test is to demonstrate that the provider tax is generally redistributive, which means that the tax generally derives revenue from non-Medicaid services. Provider taxes that are not broad based and uniform or granted a waiver by CMS are impermissible and will result in a reduction of a State's FFP, regardless of whether the resulting tax revenues are used as a source of the State share to obtain FFP.

Missouri's Provider Tax

In 2002, Missouri and CMS negotiated an agreement, the Medicaid Partnership Plan, to establish a stable funding mechanism for the State's Medicaid program. Under the agreement, CMS will accept a hospital tax as a valid State funding source if the tax program structure meets the standard for waiver of the uniformity requirements contained in Federal regulations (a test referred to as the B1/B2 test). To demonstrate that its tax met the uniformity requirements, Missouri provided CMS the results of its waiver test and stated that it complied with the standard for waiver of uniformity in 42 CFR § 433.68(e)(2)(i). As part of the implementation of the Medicaid Partnership Plan, Missouri defined the tax basis for assessing the tax as hospital operating revenue. For State fiscal year (FY) 2004, Missouri taxed 131 hospitals and used provider taxes of \$552 million as its State share to obtain \$997 million in FFP.

OBJECTIVE

Our objective was to determine whether Missouri's provider tax for State FY 2004 complied with the requirements for obtaining FFP outlined in Federal laws and regulations and the Medicaid Partnership Plan.

SUMMARY OF FINDINGS

Missouri's provider tax for State FY 2004 did not comply with the requirements for a permissible provider tax outlined in Federal laws and regulations and the Medicaid Partnership Plan. Missouri did not have policies and procedures to ensure that its provider tax program complied with Federal laws and regulations and the plan. As a result, Missouri's provider tax may have been impermissible.

The Medicaid Partnership Plan required Missouri to alert CMS to any changes to the State funding source. However, Missouri failed to notify CMS of material changes that it made to the terms of the provider tax. Missouri modified both the tax basis and tax rate without allowing CMS to review the changes prior to implementing the provider tax.

In addition, even though Missouri asserted to CMS as part of the implementation of the Medicaid Partnership Plan that it complied with the requirements of 42 CFR § 433.68(e)(2)(i), Missouri did not perform the required separate waiver tests on all classes of service taxed to demonstrate that the provider tax was permissible.

For 27 hospitals reviewed, Missouri incorrectly taxed items or services (such as office rental income, interest earned, and cafeteria revenue) that are not included in the classes of health care items or services enumerated in the regulation. Missouri also incorrectly included the revenue from these taxes in the waiver test. Section 1903(w)(3)(B) of the Social Security Act requires that provider taxes be imposed only on specified health care items or services to be permissible. Therefore, portions of Missouri's provider tax are impermissible and require a reduction in FFP.

Because Missouri materially changed the terms of the provider tax without notifying CMS and did not complete the waiver tests in accordance with Federal regulations and the Medicaid Partnership Plan, we could not determine whether the tax was generally redistributive in accordance with Federal regulations and the plan. In addition, because portions of the provider tax were impermissible, Missouri obtained \$8 million of unallowable Federal reimbursement based on the 27 hospitals we reviewed.

RECOMMENDATIONS

We recommend that Missouri:

- submit to CMS a separate waiver test for each class of service for State FY 2004,
- refund \$8,235,595 to the Federal Government,
- submit to CMS a separate waiver test for each class of service for State FYs 2005 and 2006,
- refund Federal reimbursement for the unallowable tax amounts paid by the hospitals not included in our audit and for unallowable Federal reimbursement for State FYs 2005 and 2006,
- notify CMS of any State changes to the provider tax program, and
- develop policies and procedures to ensure that the provider tax program complies with all Federal and negotiated requirements for provider taxes when completing the waiver tests.

AUDITEE'S COMMENTS

In written comments on our draft report, which are included as Appendix B, Missouri did not agree with the findings or the recommendations. Missouri disagreed that material changes were made to the tax, that multiple waiver tests were needed, and that the waiver test included incorrect amounts. To support its position, Missouri cited various Federal and State laws and regulations, as well as the Federal Register.

Missouri stated that its tax was broad based and uniform and that, for that reason, the State was not required to perform a waiver test or several waiver tests. Missouri stated that the waiver test was relevant only insofar as it was used for the purposes of the Medicaid Partnership Plan. However, Missouri did state that it was prepared to ask its providers to classify all hospital costs into two categories, inpatient and outpatient, and to submit the results of two waiver tests.

Further, Missouri cited the Federal Register to support its position that its tax was permissible. Specifically, Missouri stated that it could include revenues from taxes on items and services that are not included in the allowable classes of health care items and services enumerated in Federal regulations.

Finally, Missouri stated that even if these revenue sources were ruled to be impermissible, the recoverable Federal portion of the taxes should be approximately \$8 million rather than \$23 million.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We disagree with Missouri and continue to believe that the provider tax as implemented did not comply with Federal laws and regulations and the Medicaid Partnership Plan. Because Missouri signed the Medicaid Partnership Plan with CMS, the State is bound by the provisions of the document—among which is the mandate that Missouri's tax structure comply with the laws and regulations governing the Medicaid program. Moreover, Missouri did not correctly interpret or comply with the requirements for a permissible provider tax.

Federal laws and regulations require the Missouri provider tax, as a health care-related tax, to comply with standards to which other, non-health care-related taxes are not subject. Specifically, health care-related taxes may only be imposed on certain specified classes of health care items or services. Accordingly, we found that a portion of Missouri's provider tax was impermissible. In its response, Missouri cited language in the Federal Register in support of its practices. However, Missouri's reliance on this language was misplaced because it was taken out of context and misinterpreted in such a way that it was contrary to the statute. Thus, we continue to believe that those items and services that Missouri taxed, which are not among the specific classes listed in the regulation, are impermissible.

The Medicaid Partnership Plan requires Missouri to notify CMS of any changes to the terms of its provider tax. The Medicaid Partnership Plan also requires adherence to the Federal regulation, which requires separate waiver tests for each class of service taxed. Further, the hospital services that Missouri taxed clearly fall into more than the single category on which Missouri performed its waiver test, or the two categories—inpatient and outpatient—that Missouri now identifies. For example, home health agency services can be classified as neither inpatient nor outpatient, per Federal regulations. Consequently, Missouri should submit a separate waiver test for each class of service taxed.

We agree with Missouri's calculation of the recoverable Federal portion and have amended the report to indicate that Missouri should return \$8 million to the Federal Government.

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INTRODUCTION

BACKGROUND

Medicaid Provider Tax Program

Title XIX of the Social Security Act (the Act) authorizes Federal grants to States for Medicaid programs to provide medical assistance to persons with limited incomes and resources. The States administer the Medicaid program in accordance with Federal law and regulations. The Federal Government, through the Centers for Medicare & Medicaid Services (CMS), and the States share in the cost of the program. The Federal share of Medicaid program expenditures is known as Federal financial participation (FFP).

The Medicaid Voluntary Contribution and Provider-Specific Tax Amendments of 1991 (Public Law 102-234) authorizes States to levy health care-related taxes (provider taxes) on hospitals.¹ States may use the proceeds from provider taxes to help finance their share of the Medicaid program and to obtain FFP.

Permissible provider taxes must be broad based and uniform. To be broad based, a provider tax must be imposed on all health care items or services or on all providers of such items or services within a class of health care items or services. Federal regulations specify 19 classes of health care items or services, such as inpatient, home health, and therapy services. To be uniform, a provider tax must be imposed at a uniform rate on all items or services within a class.

States may obtain a waiver from the broad-based and uniformity requirements. To obtain a waiver, Federal regulations require States to perform a specific waiver test for each class of health care item or service taxed. The purpose of the waiver test is to show that the provider tax is generally redistributive, which means that the tax generally derives revenue from non-Medicaid services. Provider taxes that are not broad based and uniform or granted a waiver by CMS are impermissible and will result in a reduction of a State's FFP, regardless of whether the resulting tax revenues are used as a source of the State share to obtain FFP.

CMS may recover FFP from States whose provider tax programs do not meet Federal requirements (42 CFR § 433.70(b)). Specifically, CMS deducts the provider tax revenue that does not meet the requirements of 42 CFR § 433.68 from the State's Medicaid expenditures before calculating Federal reimbursement.

Missouri's Medicaid Provider Tax

Missouri finances its share of the Medicaid program through State appropriations and its provider tax. In 1994, Missouri implemented the hospital provider tax and began taxing hospitals at a specific amount per inpatient hospital day. In 1997, Missouri changed the tax basis and began taxing hospitals at a specific rate of net operating revenues. Since 1997, Missouri has

¹The Medicaid Voluntary Contribution and Provider-Specific Tax Amendments of 1991 (Public Law 102-234) added section 1903(w) to the Act.

made further changes to its Code of State Regulations (CSR) to redefine the revenues taxed.² Missouri uses the provider taxes to finance its required State share of Medicaid expenditures.

In December 2002, CMS and Missouri reached an agreement, the Medicaid Partnership Plan, on several policy and funding disputes related to Missouri's provider tax. The purpose of the Medicaid Partnership Plan ". . . is to establish a stable funding mechanism for the State's Medicaid program that embodies accountability while assuring the availability of financial resources to provide needed health care." The Medicaid Partnership Plan requires Missouri's provider tax program to comply with Federal provider tax and waiver requirements.

When Missouri implemented the Medicaid Partnership Plan, it requested that CMS accept the tax imposed on hospitals as a valid provider tax. To demonstrate that the tax met the uniformity requirements, Missouri provided CMS with the results of its waiver test and stated that it complied with the standard for waiver of uniformity in 42 CFR § 433.68(e)(2)(i).

In implementing the Medicaid Partnership Plan, the State defined the tax basis for assessing the tax as hospital operating revenue. Specifically, Missouri defined operating revenue as reported operating revenue minus bad debt expenses plus nonoperating revenue gains minus nonoperating losses.³ In State fiscal year (FY) 2004, Missouri assessed the tax at 5.32 percent of the tax basis. In the same year, Missouri taxed 131 hospitals and used provider taxes of \$552 million as its State share to obtain \$997 million in FFP.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether Missouri's provider tax for State FY 2004 complied with the requirements for obtaining FFP outlined in Federal laws and regulations and the Medicaid Partnership Plan.

Scope

We reviewed Missouri's provider tax program for State FY 2004 (July 1, 2003, through June 30, 2004). We reviewed 27 hospitals that paid approximately \$259 million in taxes, which Missouri used as the State share to obtain approximately \$467 million in FFP.

We did not analyze the overall internal control structure of Missouri's operations or financial management because the objective did not require us to do so.

We conducted our fieldwork at the offices of the State Division of Medical Services and the Missouri Hospital Association in Jefferson City, Missouri, and at the 27 hospitals.

²See 13 CSR 70-15.110(1)(B)(1)-(11).

³Letter dated December 2, 2002, from the Missouri Medicaid Director to the CMS Director for Medicaid and State Operations.

Methodology

To accomplish our objective, we:

- reviewed the applicable Federal Medicaid laws and regulations, the Missouri CSR, and the Medicaid Partnership Plan;
- interviewed officials from CMS, Missouri, and the Missouri Hospital Association to understand how Missouri developed and implemented its provider tax;
- examined the American Hospital Association's year 2000 annual licensing surveys and the 27 hospitals' accounting records to determine whether Missouri correctly calculated and collected the provider tax amounts used in the waiver test;
- analyzed the provider tax and Medicaid revenue amounts reported by each of the 27 hospitals used in the waiver test to determine whether Missouri conducted the test in accordance with Federal regulations;
- analyzed the 27 hospitals' accounting records to identify the classes of items or services that were taxed; and
- examined the quarterly summary reports that Missouri submitted to CMS to determine whether the reports complied with the waiver reporting requirements for the sources and uses of the provider tax.

We conducted our audit in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

Missouri's provider tax for State FY 2004 did not comply with the requirements for a permissible provider tax outlined in Federal laws and regulations and the Medicaid Partnership Plan. Missouri did not have policies and procedures to ensure that its provider tax program complied with Federal laws and regulations and the plan. As a result, Missouri's provider tax may have been impermissible.

The Medicaid Partnership Plan required Missouri to alert CMS to any changes to the State funding source. However, Missouri failed to notify CMS of material changes that it made to the terms of the provider tax. Missouri modified both the tax basis and tax rate without allowing CMS to review the changes prior to implementing the provider tax.

In addition, even though Missouri asserted to CMS as part of the implementation of the Medicaid Partnership Plan that it complied with the requirements of 42 CFR § 433.68(e)(2)(i), Missouri did not perform the required separate waiver tests on all classes of service taxed to demonstrate that the provider tax was permissible.

For the 27 hospitals we reviewed, Missouri incorrectly taxed items or services (such as office rental income, interest earned, and cafeteria revenue) that are not included in the classes of health care items or services enumerated in the regulation. Missouri also incorrectly included the revenue from these taxes in the waiver test. Section 1903(w)(3)(B) of the Act requires that provider taxes be imposed only on specified health care items or services to be permissible. Therefore, portions of Missouri's provider tax are impermissible and require a reduction in FFP.

Because Missouri materially changed the terms of the provider tax without notifying CMS and did not complete the waiver test in accordance with Federal regulations and the Medicaid Partnership Plan, we could not determine whether the tax was generally redistributive in accordance with Federal regulations and the plan. In addition, because portions of the provider tax were impermissible, Missouri obtained \$8 million of unallowable Federal reimbursement based on the 27 hospitals we reviewed.

FEDERAL REGULATIONS AND THE MEDICAID PARTNERSHIP PLAN

Federal Waiver Regulations Require Specific Tests

Pursuant to Federal law and regulations (section 1903(w)(3)(B) of the Act and 42 CFR § 433.68), a provider tax must be broad based and uniform to be permissible. If the tax is not broad based and uniform, States are required to request a waiver from either or both requirements. Federal regulations (42 CFR § 433.68) require States to perform specific tests to qualify for a waiver. Pursuant to 42 CFR § 433.68(e), States must perform these tests on a per class of service basis to demonstrate that the provider tax is permissible. In addition, Federal law and regulations limit provider taxes to 19 defined classes of health care items or services. Accordingly, provider taxes on items or services not included in any of the 19 classes are not permissible.

To complete the waiver tests in accordance with 42 CFR § 433.68(e)(2), States must compare the actual taxed amounts with the Medicaid revenues that the providers received. The tests determine whether the provider tax generally derives revenue from non-Medicaid services.

Pursuant to 42 CFR § 433.72(b): "In order for CMS to approve a waiver request that would permit a State to receive tax revenue . . . , the State must demonstrate, to CMS's satisfaction, that . . . (1) The net impact of the tax and any payments made to the provider by the State under the Medicaid program is generally redistributive, as described in § 433.68(e).[Emphasis added.]"

Addendum to Medicaid Partnership Plan Requires Missouri To Perform Uniform Waiver Test

Section III of the Addendum to the Medicaid Partnership Plan states:

In those instances where providers subject to an otherwise valid health-care related tax have an agreement for redistribution of Medical Assistance payments received from the State, the redistribution arrangement will be subject to CMS review and approval. CMS will accept the taxes as a valid state funding source if:

1) there is no explicit hold harmless in state law, regulation, or policy, 2) the tax program structure at issue meets the B1/B2 standard of 1.0 or above [the waiver test] contained in the federal regulations (42 CFR § 433.68(e)), after taking into account the redistribution arrangement

Medicaid Partnership Plan Requires Missouri To Notify Centers for Medicare & Medicaid Services of Changes to Provider Taxes

According to section II.B.2 of the Medicaid Partnership Plan:

. . . once a state funding source has been reviewed and accepted by CMS, no further review of the source will take place during the time frame of the Medicaid Partnership Plan as long as no change has been made in the terms of the funding source It is the State's responsibility to notify CMS of any changes in the terms of a funding source

NONCOMPLIANCE WITH FEDERAL REQUIREMENTS

Missouri's provider tax for State FY 2004 did not comply with Federal laws and regulations and the Medicaid Partnership Plan. Missouri did not notify CMS of material changes to the terms of the provider tax in accordance with the plan. In addition, Missouri did not perform a separate waiver test for each class of service taxed, even though Missouri asserted to CMS as part of the implementation of the Medicaid Partnership Plan that it complied with the requirements in 42 CFR § 433.68(e)(2)(i). Also, Missouri incorrectly taxed items that are not included in the permissible classes of items and services and incorrectly included the tax revenue for these items in the waiver test.

Missouri Did Not Notify Centers for Medicare & Medicaid Services of Material Changes to the Provider Tax

Missouri made material changes to the terms of the provider tax without notifying CMS. Specifically, Missouri changed both the tax basis and the rate that it used to tax the providers. As part of the implementation of the Medicaid Partnership Plan, Missouri submitted the results of the waiver test to CMS in December 2002. Missouri indicated that the tax was imposed on operating revenue, which Missouri defined as reported operating revenue minus bad debt plus nonoperating revenue gains minus nonoperating losses. In July 2003 (the initial effective date of the Medicaid Partnership Plan), the State imposed a tax on total operating revenue less tax revenue/other government appropriations plus nonoperating gains and losses.⁴

In addition, Missouri changed the tax rate twice during State FY 2004. The tax rate was 5.64 percent as published June 2, 2003. As of September 18, 2003, the tax rate was reduced to

⁴As stated in 13 CSR 15-70.110(11).

5.23 percent.⁵ As of June 17, 2004, Missouri changed the tax rate to 5.32 percent.⁶ Because each of these rates was applicable to the entire State FY, the last change was the final rate used for the year. CMS officials stated that as a result of the changes in the tax basis and tax rates, CMS would have required Missouri to submit new waiver tests in accordance with the Medicaid Partnership Plan to demonstrate whether the provider tax was generally redistributive.

Missouri Performed Only One Waiver Test

Missouri did not perform the required separate waiver tests to demonstrate that the provider tax was generally redistributive. Based on our review of 27 hospitals' reported revenues, Missouri taxed 12 different classes of service:

1. inpatient hospital services,
2. outpatient hospital services,
3. nursing facility services,
4. physician services,
5. home health care services,
6. outpatient prescription drugs,
7. ambulatory surgical center services,
8. dental services,
9. psychological services,
10. therapist services,
11. nursing services, and
12. emergency ambulance services.

In accordance with the Medicaid Partnership Plan, on December 4, 2002, Missouri submitted a letter to CMS requesting that CMS accept the taxes imposed on hospitals as a valid provider tax. In the letter, Missouri stated: "Pursuant to Paragraph III of the Missouri-Specific Transition Agreement entered into contemporaneously with the Medicaid Partnership Plan, the redistribution arrangement . . . has been tested against the standard for waiver of the uniformity requirements contained in 42 CFR § 433.68(e)(2)(i)[B1/B2]." Missouri also stated that the data attached to the letter demonstrated that, taking into account the redistribution, the tax met the uniformity waiver standard and was generally redistributive under the Federal waiver regulation.

However, Missouri incorrectly performed a single waiver test on all 12 classes of service rather than a separate test for each class of service as required by 42 CFR § 433.68(e) and the Medicaid Partnership Plan.

Provider Tax and Waiver Test Included Incorrect Amounts

Missouri incorrectly taxed items that are not included in the permissible classes of health care items and services. The revenue from these taxes was also incorrectly included in the waiver test, and this revenue also served as the basis for additional Federal reimbursement. Based on

⁵As published in the Missouri Register on October 15, 2003.

⁶As published in the Missouri Register on July 15, 2004.

our review of 27 hospitals, Missouri received approximately \$13 million in tax proceeds⁷ from revenue amounts (such as office rental income, interest earned, and cafeteria revenues) that are not classes of service pursuant to 42 CFR § 433.56(a). Therefore, these tax amounts are not permissible provider taxes and should be deducted from the State's Medicaid expenditures before calculating FFP.

LACK OF POLICIES AND PROCEDURES

Missouri did not develop policies and procedures to ensure that its provider tax complied with Federal regulations, nor did it have adequate internal controls to correctly complete the waiver tests or to ensure that CMS was notified of changes to the tax program. Specifically, Missouri did not have formal written guidelines for the operation of its provider tax program. Consequently, Missouri did not provide clear instructions to hospitals on which revenues to report for taxation purposes. In addition, Missouri relied on the American Hospital Association's licensing and certification data, which did not contain sufficient data for the provider tax requirements.

UNALLOWABLE FEDERAL REIMBURSEMENT

Because Missouri did not comply with Federal regulations and the Medicaid Partnership Plan, Missouri received unallowable Federal reimbursement. Because Missouri failed to notify CMS of material changes to the provider tax program and performed a single waiver test for numerous classes of service, we could not determine whether the waiver test result was valid. In addition, for the \$13 million attributable to an impermissible provider tax, Missouri received approximately \$23 million in Federal reimbursement for the 27 hospitals. Because of limitations imposed by Federal requirements,⁸ we are only questioning approximately \$8 million, which is calculated by multiplying the impermissible portion of the tax by the Federal matching rate (\$13 million x 64.36 percent). However, we also recognize that Missouri received an additional \$15 million (\$23 million - \$8 million) in Federal matching funds. (See Appendix A.)

We are recommending that Missouri submit a revised waiver test for each class of service for State FY 2004. Because we identified specific revenue attributable to an impermissible provider tax, we are recommending that Missouri refund the \$8 million.

RECOMMENDATIONS

We recommend that Missouri:

- submit to CMS a separate waiver test for each class of service for State FY 2004,
- refund \$8,235,595 to the Federal Government,

⁷See Appendix A.

⁸Section 1903(w)(1)(A)(ii) and 42 CFR § 433.70(b) of the Act.

- submit to CMS a separate waiver test for each class of service for State FYs 2005 and 2006,
- refund Federal reimbursement for the unallowable tax amounts paid by the hospitals not included in our audit and for unallowable Federal reimbursement for State FYs 2005 and 2006,
- notify CMS of any State changes to the provider tax program, and
- develop policies and procedures to ensure that the provider tax program complies with all Federal and negotiated requirements for provider taxes when completing the waiver tests.

AUDITEE'S COMMENTS

In written comments on our draft report, Missouri did not agree with the findings or the recommendations. Specifically, Missouri stated that its provider tax complied with Federal regulations and that the State had not applied for any waiver of compliance from CMS. To support its position, Missouri cited various Federal and State laws and regulations, as well as the Federal Register.

Missouri stated that there has been no change in the tax basis since the Medicaid Partnership Plan was put in place and that the clarification in the way that it determined and reported operating revenue did “. . . not reflect any substantive change in the tax base.” Missouri also stated that the “minor modifications” it made to the tax rate were “. . . not substantial enough to require CMS notification and approval.”

Missouri also stated its provider tax complied with the Federal regulations that required the tax to be broad based and uniform. As such, Missouri stated that it was not required to perform a waiver test or several waiver tests. Further, Missouri stated that the waiver test was relevant only insofar as it was used for the purposes of the Medicaid Partnership Plan. However, Missouri also said that it is prepared to ask providers to perform separate waiver tests for two classes of health care services: inpatient and outpatient hospital services. In making this point, Missouri cited a State law that identifies only these 2 classes of health care services (as opposed to the 19 different classes of health care items and services specified in Federal regulation). Missouri also stated that, even within just those two classes of services, there is a certain degree of overlap between some of the service definitions, a condition which has led CMS to acknowledge that States should be afforded some flexibility in their classifications of services.

Additionally, Missouri disagreed that revenues that it derived from items or services that could not be identified as one of the specified classes of service should be excluded from the provider tax calculations. In support of this position, Missouri offered an interpretation of the Federal regulations that it believed supported its assertion that the provider tax could include revenue sources such as office rental income, interest income, and cafeteria revenues. In addition, Missouri pointed to the example of a tax on both a gas station and hospital, drawn from the Federal Register, to show that the State's provider tax is similarly a flat tax based on gross receipts.

Missouri submitted additional information to support its disagreement with the finding in our draft report that it incorrectly included Medicaid revenue from other States when it completed the waiver test.

Finally, Missouri stated that, even if these revenue sources (office rental income, interest income, cafeteria revenues) were ruled to be impermissible, the recoverable Federal portion of the taxes should be approximately \$8 million instead of \$23 million.

Missouri's comments are included in their entirety as Appendix B.

OFFICE OF INSPECTOR GENERAL'S RESPONSE

We disagree with Missouri and continue to believe that the provider tax as implemented did not comply with Federal laws and regulations and the Medicaid Partnership Plan. Moreover, because Missouri signed the Medicaid Partnership Plan with CMS, the State is bound by the provisions of that document.

In at least three different places in its comments on our draft report, Missouri disagreed with our findings by stating that its provider tax program is not operating under a CMS waiver and therefore is not required to comply with the waiver test requirement. However, Missouri entered into and is bound by the Medicaid Partnership Plan—the culmination of “extensive” negotiations with CMS. The Plan requires that Missouri notify CMS of “any change” to the tax. It also requires that Missouri submit a waiver test in compliance with Federal regulations that state waiver tests must be “applied on a per class basis.”

Missouri made material changes to the terms of its provider tax by changing its provider tax rate from 5.64 percent to 5.32 percent. Per the Medicaid Partnership Plan, as soon as Missouri made “any change” (material or otherwise) to its tax, it was required to notify CMS. CMS officials stated that had they been aware of these changes they would have required Missouri to submit a new waiver test. Thus, in our judgment—and contrary to Missouri's assertion—this change in the provider tax rate was not minor.

The Medicaid Partnership Plan requires compliance with Federal regulation 42 CFR § 433.68(e), which requires separate waiver tests for each class of health care items or services taxed. We believe that by relying on a State statute that identifies only two classes of health care services (inpatient and outpatient), Missouri is overlooking the fact that its provider tax, as a health care-related tax, must comply with the requirements placed on health care-related taxes by the Federal regulations, to which other, non-health care-related taxes are not subject. As such, we continue to believe that Missouri is required to submit a separate waiver test for each class of service taxed.

We also continue to believe that taxes on items and services that do not fit into a specific class are impermissible. Missouri relied on the gas station example from the Federal Register to support the claim that revenue sources such as office rental income, interest income, and cafeteria revenues are permissible tax revenues. However, Missouri's reliance on this example was misplaced because it was taken out of context and misinterpreted in such a way that it was

contrary to the Federal requirements.⁹ The gas station example is not relevant to the issues at hand in this review for the simple reason that gas stations are not health care providers. As such, the gas station revenue is not subject to the laws and regulations applicable to a health care-related tax. Missouri's provider tax is at all times applied to a health care provider (i.e., hospitals) and is wholly subject to the health care-related tax laws and regulations. To be permissible, the tax must be limited in its scope to only those classes of health care items and services enumerated in the Federal regulations.

Based on the information that Missouri submitted, we eliminated from this final report the finding, mentioned in our draft report, concerning the use of Medicaid revenues from other States in the waiver tests. Finally, we agree with Missouri's calculation of the recoverable Federal portion and have amended the report to indicate that Missouri should return \$8 million to the Federal Government.

While we recognize that Missouri's comments on our draft report indicated a willingness to re-evaluate and refine its policies and procedures—as witnessed in its readiness to ask its providers, on a going-forward basis, to prepare separate waiver tests for inpatient and outpatient hospital services—we also believe that a review of this nature must look backward as well as forward. Accordingly, we continue to believe that our findings and recommendations are valid.

⁹Section 1903(w)(3)(B) and 42 CFR § 433.68(c) of the Act.

APPENDIXES

TAX AMOUNT REVIEWED AND CALCULATION DETAILS

TAX AMOUNT REVIEWED
AT 27 REVIEWED HOSPITALS

Hospital Number	Tax Amount Reviewed	Impermissible Tax Amount (State Share)
1	\$5,549,573	\$92,276
2	8,040,330	491,502
3	2,976,107	37,107
4	2,144,842	28,821
5	1,009,407	64,889
6	3,259,045	83,818
7	21,615,361	716,458
8	13,480,148	484,609
9	1,246,416	5,973
10	48,807,360	2,573,265
11	12,949,265	996,720
12	13,895,929	618,391
13	982,510	19,108
14	2,908,318	32,563
15	3,313,757	122,198
16 & 17	12,686,572	1,006,825
18	10,167,208	186,050
19	4,100,022	840,722
20	2,333,836	163,157
21	12,659,034	1,059,543
22	18,883,445	1,221,687
23	22,715,080	1,078,575
24	20,106,345	571,807
25	10,334,047	257,323
26	751,505	5,687
27	1,959,993	37,065
Totals	\$258,875,455	\$12,796,139

FEDERAL SHARE CALCULATION

Provider taxes claimed on the CMS-64 ¹ / State share (A)	\$12,796,139
State participation rate (B)	35.64 %
Federal and State share (A/B = C)	\$35,903,869
Federal share (C – A)	<u>\$23,107,730</u>

¹Centers for Medicare & Medicaid Quarterly Medicaid Statement of Expenditures for the Medical Assistance Program.



**MISSOURI
DEPARTMENT OF SOCIAL SERVICES**

P. O. BOX 1527
BROADWAY STATE OFFICE BUILDING
JEFFERSON CITY
65102-1527
TELEPHONE: 573-751-4815, FAX: 573-751-3203

Matt Blunt
GOVERNOR

Deborah E. Scott
DIRECTOR

RELAY MISSOURI
for hearing and speech impaired
TEXT TELEPHONE
1-800-735-2966
VOICE
1-800-735-2466

December 7, 2006

Patrick J. Cogley
Regional Inspector General for Audit Services
Office of Inspector General
Office of Audit Services
601 East 12th Street, Room 284A
Kansas City, MO 64106

Re: Review of Missouri Provider Tax, Report No. A-07-06-01029

Dear Mr. Cogley:

The Missouri Department of Social Services hereby responds to the draft report of the above-referenced audit which was forwarded via letter dated October 25, 2006. The time for reply was extended to December 8, 2006.

The draft report evaluates Missouri's provider tax, known as the Federal Reimbursement Allowance (FRA), for State Fiscal Year (SFY) 2004 and finds it wanting in several respects. For the reasons explained below, we believe that the report's conclusions are in error.

First and foremost, we wish to emphasize that at all times Missouri's FRA tax has been broad-based and uniform within the meaning of The Medicaid Voluntary Contribution and Provider-Specific Tax Amendments of 1991, Pub. L. No. 102-234, codified at 42 U.S.C. § 1396b(w). The tax is imposed on "[e]ach hospital, except public hospitals which are operated primarily for the care and treatment of mental disorders and any hospital operated by the Department of Health, engaging in the business of providing inpatient health care in Missouri[.]" Mo. Code Regs. tit. 13 § 70-15.110(1)(B). It is therefore broad-based, because it "is imposed at least with respect to all items or services in the class furnished by all non-Federal, nonpublic providers in the State." 42 U.S.C. § 1396b(w)(3)(B); *see also* 42 C.F.R. § 433.68(c)(1).

****AN EQUAL OPPORTUNITY/AFFIRMATIVE ACTION EMPLOYER****
services provided on a nondiscriminatory basis

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The tax is also uniform. Initially, from SFY 1993 through SFY 1996, the tax was a uniform tax per patient day. Beginning in SFY 1997, the tax has been uniformly imposed on hospital revenues. For SFY 2004, the provider tax was 5.32% of the hospital's total operating revenue less tax revenue/other government appropriations plus non-operating gains and losses. Mo. Code Regs. tit. 13, § 70-15.110(11). "[I]n the case of a tax based on revenues or receipts with respect to a class of . . . providers of items or services," a tax is considered to be uniform if it "is imposed at a uniform rate for all items and services (or providers of such items or services) in the class on all the gross revenues or receipts, or net operating revenues, relating to the provision of all such items or services (or all such providers) in the State." 42 U.S.C. § 1396b(w)(3)(C)(i)(III); 42 C.F.R. § 433.68(d)(1)(iii). The FRA meets this statutory standard.

Because Missouri's tax is broad-based and uniform, the State has not applied for any waiver of compliance from the Centers for Medicare and Medicaid Services (CMS) pursuant to 42 C.F.R. § 433.68(e). However, in response to CMS's concerns regarding Missouri hospitals' private agreement to redistribute certain Medicaid payments among themselves, the State and CMS in 2002 entered into extensive negotiations culminating in the Medicaid Partnership Plan (MPP). The MPP's purpose is "to establish a stable funding mechanism for the State's Medicaid program that embodies accountability while assuring the availability of financial resources to provide needed health care to the program's beneficiaries." MPP at 1. Among other things, the MPP provides that:

In those instances where providers subject to an otherwise valid health-care related tax have an agreement for redistribution of Medical Assistance payments received from the State, the redistribution arrangement will be subject to CMS review and approval. CMS will accept the taxes as a valid state funding source if: 1) there is no explicit hold harmless in state law, regulation, or policy, 2) the tax program structure at issue meets the B1/B2 standard of 1.0 or above contained in the federal regulations (42 C.F.R. 433.68(e)), after taking into account the redistribution arrangement; and, 3) the proceeds of the taxes do not exceed the tax revenue generated from the hospital tax and nursing facility tax in effect as of June 30, 2002 [subject to certain increases].

MPP Addendum at 1-2.

Under the MPP, completion of the B1/B2 analysis is the responsibility of the participating providers or their representatives, who are required to forward the results to the State for submission to CMS. *Id.* The MPP also provides that "[a]ny change in the taxes will subject the tax to a new review by CMS under the MPP." *Id.*

On December 4, 2002, the Director of the Division of Medical Services of the State's Department of Social Services sent to CMS a letter "requesting that CMS accept as valid state funding sources the taxes imposed on hospitals and nursing facilities by the State." Letter from Gregory A. Vadner to Dennis Smith at 1

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(Dec. 4, 2002) [hereinafter "Letter"]. This letter states that the tax is imposed on a hospital's operating revenues, defined as "reported operating revenue minus bad debt plus non-operating revenue gains minus non-operating losses." *Id.* at 1 n.1. It included the B1/B2 analysis prepared by the providers establishing that the redistribution arrangement was generally redistributive. CMS has not questioned that analysis.

- I. The Findings of Noncompliance with Federal Requirements are Erroneous
 - A. Missouri Was Not Required to Secure Renewed Approval of the FRA

The draft audit report states that Missouri failed to notify CMS of two material changes to its provider tax: a change in the tax basis and change in the tax rate. In fact, there were no material changes to Missouri's hospital tax requiring renewed review and approval by CMS.

With respect to the tax basis, there has been no change since the MPP was in place. The tax has been imposed on hospital operating revenue (less bad debt) since 1997. From SFY 1997 through SFY 2001, the tax was imposed on operating revenues as reported on a hospital's base year cost report. Beginning in SFY 2002, in order to use more current information, operating revenue was determined based on information reported to and published annually by the Missouri Department of Health and Senior Services, Section of Health Statistics. The information in the report is collected as part of an annual survey conducted by the American Hospital Association and Missouri Hospital Association. Although the tax base did not change, because the revenue reported on the annual survey includes revenue derived from tax revenue and appropriations (which the cost report does not), the regulation was modified to clarify that tax revenue and appropriations was not included as part of operating revenue. This change in regulation--which predates the MPP in any event--does not reflect any substantive change in the tax base but is only a clarification based on the change in the source of reported revenue. Since SFY 2002 and continuing through SFY 2007, the provider tax has consistently been imposed on "the hospital's total operating revenue less tax revenue/other government appropriations plus non-operating gains and losses" as determined using the information published by Missouri Department of Health and Senior Services, Section of Health Statistics. Mo. Code Regs. tit. 13, § 70-15.110(9)-(14).

As for the tax rate, it is true that the State made minor modifications to the tax rate in SFY 2004.¹ The State does not understand a minor change in the tax rate to be a "change in the tax" requiring renewed review and approval under the MPP. This is because that "where States have sought and obtained waivers for existing health care related tax programs, . . . a uniform change in the rate of tax will not require a new waiver." State Medicaid Director Letter, at 2 (Oct. 9, 1997). Although the State does not operate under a waiver, the underlying view expressed here -- that a uniform change in the tax rate is not substantial enough to require

¹ The tax rate initially to be 5.64%. See 28 Mo. Reg. 1722 (Oct. 1, 2003); 28 Mo. Reg. 1044 (June 2, 2003); 28 Mo. Reg. 1023 (June 2, 2003). It was then changed to 5.23%, see 28 Mo. Reg. 1824 (Oct. 15, 2003); 28 Mo. Reg. 1755 (Oct. 15, 2003), and finally to 5.32%, see 29 Mo. Reg. 1106 (July 15, 2004); 29 Mo. Reg. 1089 (July 15, 2004).

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CMS notification and approval -- would appear to apply with equal force to the State's situation where it has a uniform and broad-based tax.

B. Missouri Was Not Required to Perform Multiple Waiver Tests

The report states that "Missouri did not perform the required separate waiver tests to demonstrate that the provider tax was generally redistributive." According to the report, the State "incorrectly performed a single waiver test on all 12 classes of service rather than a separate test for each class of service." We believe it necessary to raise several points in response.

First, the State does not operate its tax under a waiver of the uniformity requirement, and it is not required to perform a waiver test or, as the report urges, several waiver tests. Rather, the State imposes a broad-based, uniform tax. The B1/B2 test is relevant only insofar as it was borrowed, in a very limited sense, in the MPP. The MPP applies the B1/B2 test to "the tax program structure at issue." Under Missouri law, the tax program structure is on net operating revenues, without distinction as to whether the revenues are derived from inpatient hospital services, outpatient hospital services, or other sources of revenue. Furthermore, the MPP makes completion of the B1/B2 analysis the responsibility of the providers, not the State. The State's role is simply to submit the results to CMS.

Second, while the State has already indicated to CMS that, going forward, it is prepared to ask its providers to prepare separate B1/B2 tests for inpatient and outpatient hospital services, it does not agree with the draft report's position that a separate waiver test is also needed for an additional 10 classes of service said to have been taxed. Under State law, the revenue taxed falls into two (not 12) categories: inpatient hospital services, and outpatient hospital services. See Mo. Code Regs. tit. 19, § 10-33.030, Ex. D (for purposes of annual financial reporting by hospitals, defining "[t]otal gross patient revenue" as the sum of inpatient revenue and outpatient revenue, where "[i]npatient revenue" is "full hospital charges for all hospital services to inpatients" and "[o]utpatient revenue" is "full hospital charges for all hospital services to outpatients"). All of the revenue taxed is revenue earned by each hospital for providing services under the authority of its state license *as a hospital*.²

The provider tax regulations do not define the scope of what must be included in (or excluded from) "inpatient hospital services" and "outpatient hospital services" and it was reasonable for the State to impose a tax on revenues earned by the hospital within the scope of services it is authorized to provide under state law. In any case, the State believes that the services at issue all fall within the broad definitions of inpatient and outpatient hospital services in federal Medicaid regulations, as they were all furnished *in* or *by* an institution that is "licensed or formally approved as a hospital by an officially designated authority for State

² A Missouri hospital pursuant to its license may provide a range of "medical services," defined as "[t]hose preventive, diagnostic and therapeutic measures performed by, or at the request of, members of the medical staff or an independent licensed practitioner in outpatient services." Mo. Code Regs. tit. 19 §§ 30-20.021(4)(D)(1), § 30-20.011(21).

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standard-setting . . . and [m]eets the requirements for participation in Medicare as a hospital." See 42 C.F.R. §§ 440.10(a), 440.20(a).

It may be, with respect to some of the revenue taxed, that the services provided may also fall within a separate class of service. There is overlap between some of the service definitions. See, e.g., *La. Dep't of Health & Hosps. v. Ctr. for Medicare & Medicaid Servs.*, 346 F.3d 571, 576-77 (5th Cir. 2003) (rejecting the argument that outpatient hospital services and rural health clinic services are mutually exclusive). With respect to provider taxes, CMS has recognized the possibility of overlap and acknowledged that states should be afforded some flexibility in cases where services could fit within more than one class. For instance, the preamble to the final rule notes the possibility that for an HMO-owned hospital, a state might be taxing the same services twice if it taxed both HMO services and inpatient hospital services. 58 Fed. Reg. 43156, 43161 (Aug. 13, 1993). In this circumstance, CMS "will consider a tax to be broad based when the tax is imposed on all inpatient hospital services, with the exclusion for HMO owned and operated hospitals if the HMO services are also being taxed." *Id.* As another example, in answering the question whether "[i]f a State hires physicians to perform inpatient hospital services, . . . these physicians have to be excluded from the inpatient hospital tax," CMS responded:

If a State does not impose a separate tax on physician services, the inpatient hospital services performed by the physician should be subject to the tax. If, however, the State has a separate tax on physician[] services, the State may include the inpatient hospital services performed by the physician under either inpatient hospital services or under physician services.

State Medicaid Director Letter, Questions and Answers Attachment, at 6-7 (June 21, 1995).

In the case of the FRA, the State reasonably and consistently imposed its tax on the total revenues reported by the hospital for inpatient and outpatient hospital services.

C. The Provider Tax and B1/B2 Test Did Not Include Incorrect Amounts

The draft report states that the State incorrectly taxed items that are not included in the permissible classes of health care items and services and that the State incorrectly included these amounts in the waiver test. According to the report, the State received tax proceeds from cafeteria revenues and other revenue amounts that are not classes of service under 42 C.F.R. § 433.56(a) and that are therefore not permissible provider taxes. We believe that these revenue amounts did not need to be excluded and that, in any case, the draft audit grossly overestimates the amount subject to refund.

First, the statute and regulations are not as restrictive as the draft report portrays them to be. With respect to the broad-based requirement, the statute requires that the tax be "imposed with respect to a class of health care items or

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services . . . **or with respect to providers** of such items or services.” 42 U.S.C. § 1396b(w)(3)(B) (emphasis added). In the case of Missouri, the FRA is imposed with respect to providers of health care items or services (specifically, hospitals). The statute requires that the tax be “imposed **at least** with respect to all items or services in the class furnished by all non-Federal, nonpublic providers in the State . . . or [be] imposed with respect to all non-Federal, nonpublic providers in the class.” *Id.* (emphasis added). Likewise, the regulation requires that the tax be “imposed on **at least** all health care items or services in the class or providers of such items or services furnished by all non-Federal, non-public providers in the State.” 42 C.F.R. § 433.68(c)(1) (emphasis added). The State’s tax is imposed with respect to all providers of hospital services (with exceptions, not challenged in the draft report, as stated in Mo. Code Regs. tit. 13, § 70-15.110(1)(B)). This comports with the statute and regulation, including the “at least” language, which implies that the tax may be imposed with respect to items or services that are not items or services in the enumerated classes of services furnished by providers.

The State’s tax also satisfies the uniformity requirement. The tax is imposed at a uniform rate for all providers of inpatient and outpatient hospital services on all the revenues relating to the provision of these services. See 42 U.S.C. § 1396b(w)(3)(C)(i)(III); 42 C.F.R. § 433.68(d)(1)(iii). It is also imposed at a uniform rate for all other revenue sources covered under the tax, including cafeteria services and other services that are not enumerated in the statutory or regulatory lists of services.

The preamble to the interim final rule discusses an example supporting the State’s position. In the example, “a State imposes a tax of 5 percent on gross revenues of hospitals and gas stations.” 57 Fed. Reg. 55118, 55127 (Nov. 24, 1992). The tax in this example “is a flat rate based on gross receipts.” *Id.* The preamble states that “since the tax extends to all hospital services, it would be considered broad based. Further, since the tax is imposed at a flat rate on gross revenue, it satisfies the requirement that it is imposed uniformly.” *Id.* The State’s tax closely resembles the one in this example, except that the State’s hospital tax does not cover gas stations. There is no indication in the preamble that the tax may not permissibly extend to those portions of gross revenue that derive from cafeteria services and the like. In fact, if the State were limited to taxing revenue from only those services enumerated in 42 C.F.R. § 433.56, then it is difficult to imagine why this example should include gas stations. Gas stations virtually never provide the enumerated classes of services. Yet nothing in the preamble implies that the taxation of gas station revenues is impermissible or makes it impossible for the tax scheme to qualify as broad-based and uniform. Nor does anything in the final rule modify the position taken in the interim final rule.

There are other indications that the State may permissibly tax sources of hospital revenue other than those listed in 42 C.F.R. § 433.56. For instance, the preamble to the interim final rule states that “a tax imposed on inpatient hospital services, or the providers thereof, need not cover revenues or activities of hospitals not related to inpatient hospital services.” 57 Fed. Reg. 55118, 55122 (Nov. 24, 1992). The “need not” language implies flexibility on the State’s part; indeed, one would expect a statement to the effect that the State “may not” cover other

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hospital revenues if, in fact, that were the rule. See *also* Preamble to Final Rule, 58 Fed. Reg. 43156, 43165 (Aug. 13, 1993) ("States are given the flexibility to decide what is an acceptable tax base. Using facility costs as a tax base may or may not be uniform.").

Even assuming that all of the tax amount questioned in the report were impermissible, the State would not be obliged to refund \$23,107,730 to the Federal government. Under § 1903(w), "the sum of any revenues received by the State . . . during the fiscal year" from impermissible health care related taxes is, for purposes of determining the amount of Federal financial participation (FFP) to be paid to a State, to be subtracted from "the total amount expended during such fiscal year as medical assistance under the State plan." 42 U.S.C. § 1396b(w)(1)(A). The corresponding regulation provides that "CMS will deduct from a State's expenditures for medical assistance, before calculating FFP, funds from . . . revenues generated by health care-related taxes received by a State . . ., in accordance with the requirements, conditions, and limitations of this subpart, if the . . . taxes are not" permissible health-care related taxes. 42 C.F.R. § 433.57(c); see *also id.* § 433.70(b) ("CMS will deduct from a State's medical assistance expenditures, before calculating FFP, revenues from health care-related taxes that do not meet the requirements of § 433.68 . . .").

The calculation in the Appendix to the report does not comply with these rules. The correct calculation begins by subtracting the impermissible tax funding from the total amount expended under the State Medicaid plan. If the draft audit is correct that the State impermissibly collected \$12,796,139 in tax revenue, then \$12,796,139 should be subtracted from the total Medicaid expenditures. The Federal government's share of this amount is 64.36 percent, or \$8,235,595. That is the amount of any refund to which the Federal government would be entitled, if it were entitled to any at all. See, e.g., *Kentucky Dep't for Medicaid Services*, DAB No. 1524, at 1 (noting that disallowance of \$7,906,182 FFP was based on HCFA's calculation that Kentucky had collected \$10,985,385 in impermissible taxes).

Stated differently, using the example in the draft audit, the State made an expenditure of \$35,903,869 to its hospitals. Even if the draft audit is correct that the State included in that expenditure \$12,796,139 collected in impermissible taxes, it is still entitled to federal financial participation in the remaining expenditure of \$23,107,730.

D. It Was Not Error for the Hospitals to Include Medicaid Payments From Other States in the B1/B2 Showing

The draft report states that for 12 hospitals, the State included in its waiver test Medicaid revenue that the hospitals received from other states, and that this was improper under 42 C.F.R. § 433.72. We disagree with the report's position.

Under 42 C.F.R. § 433.72(b)(1), "[i]n order for CMS to approve a waiver request . . ., the State must demonstrate, to CMS's satisfaction, that . . . [t]he net impact of the tax and any payments made to the provider by the State under the Medicaid program is generally redistributive, as described in § 433.68(e)." As

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stated above, the State does not operate its tax under a waiver from CMS, and approval has not been sought or granted under § 433.72. The State's tax is broad-based and uniform. The role of the generally redistributive test under § 433.68(e) is, as described above, quite limited. We do not believe that the State is obliged to make any demonstration under § 433.72(b)(1).

As for the showing made pursuant to the MPP, we do not believe that it was improper for the providers to include Medicaid revenue that hospitals received from other states. The MPP refers only to the B1/B2 standard contained in 42 C.F.R. § 433.68(e). The "Medicaid Statistic" is the independent variable of the linear regressions that form the basis of the B1/B2 test. Nothing in 42 C.F.R. § 433.68(e)(2)(i)(A)'s definition of "Medicaid Statistic" requires that term to be restricted to a single state's Medicaid payments. On the contrary, the regulation focuses on Medicaid generally. The regulation simply states that "[t]he term 'Medicaid Statistic' means the number of the provider's taxable units applicable to the Medicaid program during a 12-month period." The regulation provides two examples that do not indicate a restriction to any particular state: "If, for example, the State imposed a tax based on provider charges, the amount of a provider's Medicaid charges paid during a 12-month period would be its 'Medicaid Statistic'. If the tax were based on provider inpatient days, the number of the provider's Medicaid days during a 12-month period would be its 'Medicaid Statistic'." *Id.* In the preamble to the final rule, CMS responded to a comment requesting clarification of the phrase "applicable to Medicaid," as used in § 433.68(e). CMS stated simply that "[t]he proportion of the tax revenue applicable to Medicaid means how much of the tax burden shifts to Medicaid." 58 Fed. Reg. 43156, 43165 (Aug. 13, 1993). There is no indication that other states' Medicaid payments must be excluded. We believe the providers have complied with all the requirements of which they were on notice.

II. Missouri's Policies and Procedures are Adequate

The draft report finds that the State did not have policies and procedures to ensure that its provider tax program complied with Federal laws and regulations and the MPP. The draft report also finds that the State lacked adequate internal controls to correctly complete the waiver tests or to ensure that CMS was notified of changes to the tax program. The report states that the State did not have formal written guidelines for the operation of its provider tax program and that, as a result, it failed to provide clear instructions to hospitals on which revenues to report for taxation purposes. The report adds that the State relied on the American Hospital Association's licensing and certification data, which did not contain sufficient data for the provider tax requirements.

The State disagrees with these findings. The State does have policies and procedures to ensure that its provider tax program complies with all applicable authority. The tax rate and the tax base are clearly spelled out in state regulations, which are updated through formal rulemaking procedures. *See, e.g.*, 13 CSR 70-15.110 (defining net operating revenues and other operating revenues and specifying the tax rate for each fiscal year).

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The tax is based on revenues officially reported to and published by the Missouri Department of Health and Senior Services, Section of Health Statistics, in conjunction with the annual survey conducted by the American Hospital Association and Missouri Hospital Association. The report is an official state document; the information is reported consistent with national standards for hospital revenues; and it contains more current information than that contained on hospital cost reports. If the information needed for the tax is not available through the annual report, the State uses Medicaid data from the hospital's cost report. *See, e.g.*, 13 CSR 70-15.110(11). The State therefore disagrees that the annual report does not contain sufficient data for provider tax requirements.

The State also disagrees with the finding that CMS is not kept informed of the State's administration of the tax program. Even before implementation of the MPP, and continuing to this day, CMS has requested (and the State has provided) quarterly reports with the amount of tax revenue collected from each hospital. The CMS 37 and CMS 64 reports include an "FRA Summary" that reports revenues collected and projected revenues that specify the tax rate in effect each state fiscal year. In addition, as part of the MPP, the State also reports to CMS projections of the amount of tax it expects to collect in the coming year.

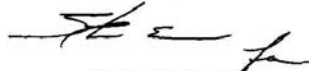
III. The Department's Responses to the Report's Recommendations

For the reasons given above, the State does not agree with the findings in the draft audit or the recommendations proceeding therefrom.

The MPP is scheduled to expire in 2007, and the State is currently in discussions with CMS about extending its term. In the context of those discussions, the State is willing to discuss whether CMS would have the providers modify how they conduct the B1/B2 analysis going forward. For example, the State has already informed CMS that it is prepared to ask the providers to conduct separate B1/B2 analyses for inpatient and outpatient hospital services, using the revenues reported by the hospital for these categories of service on a prospective basis.

Thank you for the opportunity to comment on the draft report. Please do not hesitate to contact Steven E. Renne, Interim Director, Division of Medical Services, at 573/751-6922 if you have any questions regarding these responses.

Sincerely,



Deborah E. Scott
Director

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