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State Hospital and Medical Provider Taxes: Not What the Doctor Should Order

Tax Foundation Fiscal Fact No. 203

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Summary

Taxing health care to pay for health care seems counterintuitive, but it is increasingly popular with state governments. Budgets are strained and Medicaid demand is up. In response, states are raising many taxes, and health care providers are an increasingly popular target because the revenue raised from those taxes can be used to obtain a larger amount of federal matching funds. States shift Medicaid revenues to their general funds while shifting Medicaid costs to the federal government.

Twenty-two states have significant health provider or hospital taxes, and six of those have been enacted or expanded within the last year. Four enactments or expansions are pending.

Background and Analysis

Medicaid is financed at both the federal and state levels. When states raise money they plan to spend on Medicaid, they receive matching funds from the federal government depending on the state's level of poverty and unemployment. For example, during Federal Fiscal Year 2009, Mississippi had the highest federal matching fund rate (Federal Medical Assistance Percentages, FMAP) and received $5.10 for each dollar the state spent on Medicaid. For each dollar Wyoming spent on Medicaid, the feds kicked in $1.28-the lowest rate in the country. The American Recovery and Reinvestment Act of 2009 provides increased matching rates for Medicaid during the period October 1, 2008 through December 31, 2010, totaling an additional $87 billion in federal funding. (Table 1 shows data on state health provider taxes and the federal matching that can result.)

A tactic used by some states for bridging their budgetary gaps is to tax health care providers, use the collected revenue to qualify for additional matching funds from the federal government, and then use those federal dollars to compensate Medicaid providers. Medicaid is an entitlement program, and so long as states meet eligibility criteria, federal matching is open-ended. As states get more federal funds for Medicaid, the federal government must tax or borrow to pay for this spending increase.

In 2009, Wisconsin Governor Jim Doyle signed into law a state budget including a 20% increase in the health provider tax enacted just three months earlier. The increase would result in federal Medicaid matching funds increasing from $635 million to $796 million. It is estimated that $292 million of that amount will be used for non-Medicaid purposes.[2] In 2004, the U.S. government's General Accounting Office (now the Government Accountability Office) reported that intergovernmental transfers-transfers of funds from one government agency to another-have enabled states to funnel Medicaid matching funds into state general coffers.[3] Table 2 shows recent estimates for the "returns" on hospital taxes.

Table 1: States with Health Provider Taxes					
States	Federal Matching Funds Rate (FY2009 FMAP, ARRA rates)	Federal Contribution for Every Spent State Medicaid Dollar [1]	With Significant Provider or Hospital Taxes	Enacted or Expanded within Last Year	Tax or Expansion Proposed Recently
Alabama	76.6%	$3.28			
Alaska	58.7%	$1.42			
Arizona	75.0%	$3.00			
Arkansas	79.1%	$3.79	X		X
California	61.6%	$1.60	X	X	
Colorado	58.8%	$1.42	X	X	
Connecticut	60.2%	$1.51			
Delaware	60.2%	$1.51			
Florida	67.6%	$2.09	X		
Georgia	73.4%	$2.76			
Hawaii	66.1%	$1.95			
Idaho	78.4%	$3.62			
Illinois	60.5%	$1.53	X		
Indiana	73.2%	$2.73			
Iowa	68.8%	$2.20			
Kansas	66.3%	$1.96	X		
Kentucky	77.8%	$3.50	X		
Louisiana	80.0%	$4.00			
Maine	72.4%	$2.62	X		
Maryland	58.8%	$1.42			
Massachusetts	58.8%	$1.42	X		
Michigan	69.6%	$2.28	X		X
Minnesota	60.2%	$1.51	X		
Mississippi	83.6%	$5.10	X		
Missouri	71.2%	$2.47	X	X	
Montana	76.3%	$3.21	X		
Nebraska	65.7%	$1.91			
Nevada	63.9%	$1.77			
New Hampshire	56.2%	$1.28			
New Jersey	58.8%	$1.42			
New Mexico	77.2%	$3.39			
New York	58.8%	$1.42	X		
North Carolina	73.6%	$2.78			
North Dakota	70.0%	$2.32			
Ohio	70.3%	$2.36	X	X	
Oklahoma	74.9%	$2.99			
Oregon	71.6%	$2.51	X	X	
Pennsylvania	63.1%	$1.70			
Rhode Island	63.9%	$1.76	X		
South Carolina	78.6%	$3.66	X		
South Dakota	68.8%	$2.20			
Tennessee	73.3%	$2.73			
Texas	68.8%	$2.20			
Utah	77.8%	$3.51			
Vermont	67.7%	$2.09	X		X
Virginia	58.8%	$1.42			
Washington	60.2%	$1.51			X
West Virginia	80.5%	$4.11	X		
Wisconsin	65.6%	$1.90	X	X	
Wyoming	56.2%	$1.28			
Sources: Tax Foundation; Department of Health and Human Services; National Conference of State Legislatures.					

Table 2
Recent Estimates on Return from Hospital Tax ($Millions)

States	Provider Tax Revenue ($Millions)	Federal Matching Funds ($Millions)
Arkansas	$40	$100
California	$2,000	$2,300
Colorado	$600	$600
Michigan	$300	$525
Missouri*	$1,100	$1,800
Ohio	$718	$1,800
Oregon	$700	$1,000

* Reported from previous year, State FY 2008

It might seem strange to see doctors or hospital associations cheering taxes of health providers, but they often benefit because states increase payments to providers of Medicaid services along with the tax. While a hospital may pay a new tax to the state, it often receives an identical or larger amount in additional reimbursements for services provided. The ultimate purpose of the entire mechanism appears to be just obtaining additional federal funds.

Some health care providers may be harmed by these taxes, however. Generally, when hospital taxes are reimbursed by greater state Medicaid support, the benefits are dependent on the quantity of Medicaid-covered services a doctor or hospital provides. Those that provide little in Medicaid services must pay the tax without much reimbursement. The Ohio Hospital Association opposes their assessment, noting they will not be fully reimbursed from Ohio's $718 million 2009 hospital tax and that most hospitals have had to cut expenses to break even.[4]

Those states most likely to adopt this scheme of enacting or expanding hospital taxes as a way of obtaining federal funds are likely to be the states facing serious budget troubles, especially involving Medicaid payments. These conditions are present in many states recently. With the American Recovery and Reinvestment Act of 2009 increasing the federal matching rate by an average of 8.7%, states have even more incentives to take advantage of hospital taxes. Ultimately, however, health provider taxes are a short-term solution that can undermine health care providers, and rely on the tenuous continued existence of a dysfunctional Medicaid matching fund system.

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[1] If the matching rate is 80% for a state, this means that if $1.00 is spent on Medicaid the state spends $.20 and the federal government spends $.80.

[2] Brien Farley, "Wisconsin Seeks More Medicaid Money to Heal Sick State Budget," *Budget & Tax News* (Dec. 2009), at www.heartland.org/article/26299/Wisconsin_Seeks_More_Medicaid_Money_to_Heal_Sick_State_Budget.html.

[3] "Medicaid: Intergovernmental Transfers Have Facilitated State Financing Schemes," U.S. General Accounting Office (Mar. 18, 2004), at http://www.gao.gov/new.items/d04574t.pdf.

[4] "New State Hospital Tax: Extra Burden in a Failing Economy," Ohio Hospital Association, at http://www.ohanet.org/SiteObjects/57AEE3CFB2585F16682EF98E1BBE3B48/State%20Budget%20Survey%20Report.pdf.

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