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District Court Upholds Offset of Medicaid Revenue Against Amount of Allowable Provider Taxes for Medicare Purposes

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Many states assess taxes against hospitals or other providers as a means of funding their Medicaid programs. The revenues generated by the taxes are used, with CMS's approval, to fund Medicaid payments to various providers, and the federal government participates in these Medicaid payments by paying its share (called federal financial participation). Those providers reimbursed on a reasonable cost basis by Medicare have often claimed those taxes on their Medicare cost reports, and Medicare has been paying its share of those taxes. This practice is consistent with the general rule that taxes assessed against providers are allowable costs under Medicare reasonable cost principles. *See Provider Reimbursement Manual§ 2122*.

A recent federal court decision, however, casts doubt on this practice. Earlier this month, a U.S. District Court in Illinois upheld the decision of the CMS Administrator that, in determining the amount of allowable tax costs for Medicare purposes, the Medicaid revenues received from the state must be offset against the tax assessment. *Abraham Lincoln Memorial Hospital, et al. v. Sebelius [PDF]* No 3:10-cv-03122 (C.D. Ill., June 8, 2011) The Court relied heavily on the language of the Illinois statute that levied the tax assessment and created the Medicaid payments for which the funds would be used. The state statute provided that the payment of the tax was not due until after the hospital received the Medicaid payments from the state. The Court held that this language provided substantial evidence for the CMS Administrator's decision that the hospitals had not "actually incurred" the tax expense. Under the Medicare statute, Medicare can pay only those reasonable costs which are "actually incurred."

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The decision rejected the hospitals' contention that the Administrator's position constituted a change in policy from prior decisions that recognized health care provider taxes as allowable expenses without requiring any offsetting Medicaid payments. The Court held that this precise question had not been before the Administrator before, and therefore it was not a change of policy. The court used the same rationale to conclude that the Administrator was therefore free to establish a new position through adjudication, rather than go through notice-and-comment rulemaking.

The appeal period expires on August 7, 2011.

Ober|Kaler's Comments

The CMS Administrator's decision in this case, issued in March 2010, was followed by a so-called "clarification of policy" published in the FY 2011 IPPS final rule. That clarification indicated that, while provider taxes are generally allowable, Medicare contractors should review claims for such taxes to determine whether an offset of Medicaid revenues should be made. *See* 75 Fed. Reg. 50362-64 (Aug. 16, 2010) [PDF]. The clarification provided little guidance to the Medicare contractors, however, as to how they should make this determination.

The announced "clarification," combined with this district court decision, means that many more Medicare contractors will be likely to disallow costs for provider taxes by offsetting Medicaid revenues against the tax assessment. This will affect not only critical access hospitals but also IPPS hospitals that have certain costs, such as organ procurement, still paid on a reasonable cost basis. At a minimum, providers and their hospital associations should be working with their Medicaid agencies, where possible, to fashion provider tax programs in such a way that Medicare cannot assert that the providers do not "actually incur" the tax expense.