Oregon
Kate Brown, Governor

Department of Human Services
Office of Developmental Disabilities Services
500 Summer St. NE E-09
Salem, OR 97301-1073
Voice: 503-945-5811
Fax: 503-373-7274
TTY: 800-282-8096

November 19, 2015

The Honorable Senator Richard Devlin
The Honorable Representative Peter Buckley
Interim Joint Committee on Ways and Means
900 Court Street NE
Salem OR 97301-4048

Dear Co-Chairs,

During the 2015 legislative session, the Oregon State Legislature instructed the Office of Developmental Disabilities Services (ODDS) in the Department of Human Services (DHS) "*to assess the feasibility, potential benefits, and potential drawbacks of a provider assessment, or transient lodging tax, on the provider organizations serving adults with IDD, with the goal of maximizing federal matching funds for IDD services and addressing the direct care workforce shortage".*

This letter reports on the findings of this assessment process which is due back to the Legislature by December 1, 2015.

In response to the budget note, ODDS brought together a stakeholder group that included leadership from DD provider agencies and representatives of their trade associations. ODDS also worked the Department of Justice (DOJ), Oregon Health Authority and expert consultants to develop a feasibility analysis. Actions undertaken include:

1. ODDS requested research and review to be performed by DOJ, including the DOJ Tax and Finance section.
    a. Meetings occurred on September 10, 2015 and on October 13, 2015.

2. ODDS and DOJ requested opinion from consulting firm Covington & Burling LLP.
    a. The opinion memo is attached for review.
3. ODDS discussed the Lodging Tax proposal with the Oregon Health Authority (OHA).
    a. After significant consideration, it was decided to hold on contacting the Centers for Medicare and Medicaid Services (CMS) until more specific direction is provided in response to this report.
4. ODDS held two meetings with the stakeholder group to review progress and collect input.
    a. Those meetings were held on October 15, 2015 and on November 6, 2015.

DD Provider Lodging Tax

Based on research conducted, in order to implement this Lodging Tax, DD providers of group home and supportive living services would need to be added to the existing transient lodging tax (ORS 320.300). This tax is currently assessed at a rate of 1% of gross revenues. Five percent of the taxes collected may be retained by the lodging provider as compensation for administering the tax.

The levying of health care-related taxes to meet the non-Federal share of Medicaid costs is controlled by the regulations at 42 CFR §433.55 et seq. This CFR and Centers for Medicare and Medicaid Services (CMS) has excluded home and community based programs as a permissible class for a health care related tax.

To avoid being classified as a health care-related tax under this tax provision, the amount of tax revenue attributed to health care providers must not exceed 85% of the total revenue generated across all subjects taxed under the particular taxing regulation. Additionally, according to the Center for Medicare and Medicaid Services (CMS) letter to state Medicaid Directors on Health Care Related Taxes on July 25, 2014, the tax would need to be imposed on DD providers in the same way it is imposed on other

service providers being taxed under this particular taxing regulation. CMS clarified in its letters that "taxing a subset of health services or providers at the same rate as a statewide sales tax, for example, does not result in equal treatment if the tax is applied specifically to a subset of health care services or providers (such as only Medicaid MCOs), since the providers or users of those health care services are being treated differently than others who are not within the specified universe." Including only DD residential providers, as compared to residential providers of services for aging population, may need to be examined closely to ensure that the tax satisfies this condition.

In order to implement the lodging tax with DD Providers, the following changes to the existing transient lodging tax law would be needed:

1. Change of the requirement around "temporary human occupancy" as less than 30 days of stay. Broad impacts on the industry currently subject to the lodging tax are unknown to DHS and should be carefully considered prior to implementing this change.

2. Amend the following exemption to apply the tax to DD providers:

   320.308 Exemptions. The following are exempt from the state transient lodging tax:

   "(1) A dwelling unit in a hospital, health care facility, long term care facility or any other residential facility that is licensed, registered or certified by the Department of Human Services or the Oregon Health Authority

3. Amend the statutes to make clear that the legal incidence of the tax falls solely on the lodging tax provider or intermediary, rather than the lodger-consumer. However, before doing so, DOJ strongly recommends consulting again with DOJ Tax and Finance, because such a change has ramifications in other areas, including tribal tax and the scope of federal immunity from state taxes. Section 2493 of the State Medicaid Manual makes a distinction between taxes imposed on the seller (which can be reimbursed as an expense under Medicaid) and those imposed on the consumer (which cannot be "passed on" to Medicaid). In other words, where the tax is imposed

on the consumer, the ability to draw additional federal match on generated tax revenue is not permitted.

DHS roughly estimates that the tax would have generated approximately $6.175 million in tax revenue for the 15-17 biennium:

Category	**Biennial Revenue**
Adult 24-Hr Residential Services – Group Homes	$579 M
Supported Living	$72 M
Revenue total:	$651 M
1% Tax	**$6.5 M**
Less: 5% Rebate	**($325 K)**
Net Tax Revenue	**$6.175 M**

Tax revenue would be reinvested back into the home and community based services provided to individuals with intellectual and developmental disabilities.

ODDS staff that worked on gathering this information are available to answer any additional questions on this topic.

Sincerely,

Lilia Teninty, Director
Office of Developmental Disabilities Services

CC: Laurie Byerly, Legislative Fiscal Office
Ken Rocco, Legislative Fiscal Office
George Naughton, Department of Administrative Services
Tamara Brickman, Department of Administrative Services

Enclosure: Covington & Burling LLP Opinion Memo

DRAFT
November 20, 2015

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BEIJING BRUSSELS LONDON LOS ANGELES
NEW YORK SAN FRANCISCO SEOUL
SHANGHAI SILICON VALLEY WASHINGTON

Caroline M. Brown

Covington & Burling LLP
One CityCenter
850 Tenth Street, NW
Washington, DC 20001-4956
T +1 202 662 5219
cbrown@cov.com

Oregon Department of Human Services

November 17, 2015

Dear Jeff Wahl:

You have asked us to assess "the feasibility, potential benefits, and potential drawbacks of a provider assessment, or transient lodging tax" on the provider organizations serving adults with intellectual or developmental disabilities (IDD), with the goal of maximizing federal matching funds for IDD services and addressing the direct care workforce shortage. As set forth below, we believe that extending the transient lodging tax is feasible, but would have to be carefully constructed to ensure compliance with CMS rules requiring "equal treatment" of taxpayers.

Analysis

Section 1903(w) of the Social Security Act, and implementing regulations at 42 C.F.R. §§ 433.55-.72, impose a number of requirements related to "health care related taxes." A tax that is considered to be "health care related" and not compliant with these regulations will have an adverse effect on a State's federal financial participation (FFP) in the Medicaid program. Specifically, an impermissible health care-related tax will result in a loss of FFP equal to the federal share of the tax raised, whether or not the tax proceeds are used to fund Medicaid.

We have divided our analysis into three questions:

1. *Can a provider assessment on IDD provider organizations be a valid health-care related tax?*
2. *Can the transient lodging tax be extended to IDD without being considered a health-care related tax?*
3. *If the tax is a permissible tax, can DHS reimburse the cost of the tax to IDD providers?*

We address each of these in turn.

1. Can a provider assessment on IDD provider organizations be a valid health-care related tax?

Medicaid rules impose a number of requirements on "health care-related taxes," including that they be "broad-based," "uniform," and do not contain a "hold harmless." One of the requirements of a health-care related tax is that it be imposed on a class of providers specified in federal rules at 42 C.F.R. § 433.56. While ICF/IIDs are a listed class, other IDD providers are not among the class of providers listed. Therefore, a tax on non-ICF IDD providers could not be a valid health-care related tax, and such a tax would result in a federal disallowance equal to the federal share of the revenues raised.

2. *Can the transient lodging tax be extended to IDD without being considered a health-care related tax?*

Regulations at 42 C.F.R. § 433.55(b) provide that "[a] tax will be considered to be related to health care items or services . . . if at least 85 percent of the burden of the tax revenue falls on health care providers." The negative implication of this rule is that a general tax will not be considered to be health care related if more than 15% of the burden falls on individuals or entities that are not health care providers. However, even in such a situation, a tax will still be considered to be health care related if "the treatment of individuals or entities providing or paying for those health care items or services is different than the tax treatment provided to other individuals or entities." 42 C.F.R. § 433.55(c). In 1993, when CMS finalized the rules, it gave as examples of unequal treatment (a) a tax on non-health care providers at a different rate than a tax on health care providers; (b) credits and rebates that treat health care providers differently; (c) a tax on a unit that is more prevalent in a health care setting (e.g., bedpans). *See* 58 Fed. Reg. 43156, 43160 (Aug. 13, 1993).

Therefore, including IDD providers in the transient lodging tax would not be considered a health care related tax if: (1) more than 15 percent of the proceeds from the tax derive from non-health care-related entities (other transient lodging providers), and (2) the tax treatment of the IDD providers is not different than that of non-health care-related taxpayers subject to the transient lodging tax.

In the past, some States relied on the above regulations to extend existing State taxes to managed care organizations participating in the Medicaid program ("Medicaid MCOs"). They did this because Medicaid MCOs are not a permissible taxable class. In May 2014, the Office of the Inspector General ("OIG") released an audit concluding that Pennsylvania's tax appeared to be an impermissible health care related tax. *See* Audit No. A-03-13-00201. In response, CMS noted that it had "not specifically provided guidance on the inclusion of Medicaid health care providers or services into larger non-health-care related taxes" and that it would "not pursue financial recoveries for periods prior to issuance of national guidance." *Id.* at 26.

In July 2014, the Centers for Medicare & Medicaid Services (CMS) issued the national guidance that it had alluded to in response to the Pennsylvania audit. In a State Health Official

("SHO") letter, CMS clarified that it considered general taxes that included Medicaid MCOs to be health-care related taxes. First, the letter states that the 85% provision "does not establish a safe harbor for any tax on health care providers that falls below the threshold." SHO, at 2. In that case, "the relationship of such taxes to health care items and services must still be analyzed to determine if there is equal treatment of providers or payers in the design and application of the tax." *Id.* With respect to a general tax that is extended to Medicaid providers, the letter states that "[t]axing a subset of health care services or providers at the same rate as a statewide sales tax . . . does not result in equal treatment if the tax is applied specifically to a subset of health care services or providers . . . since the providers or users of those health care services are being treated differently than others who are not within the specified universe." *Id.* States that had such taxes were given a period of time in which to change their tax structure consistent with the guidance.

The July 2014 SHO letter does not close the door to including health care providers in a general tax, but it does make clear that CMS will impose a rigorous review to ensure that any providers so included receive "equal treatment." The letter also makes clear that taxing providers by reference to the fact that they participate in the Medicaid program is not "equal treatment."

In light of the above, an extension of the transient lodging tax to include IDD residential providers would have to be structured so that (1) the treatment of IDD residential services is the same as on other taxpayers subject to the tax; (2) the IDD residential services subject to the tax are not identified by reference to their participation in the Medicaid program. With respect to the first factor, the State would need to ensure that the definition of "transient lodging" or "temporary human occupancy" is the same for IDD residential providers and other taxpayers; that the tax rate is the same; and that exemptions and/or credits for all taxpayers are the same, for example. With respect to the second factor, the taxed services could not be limited to services provided to Medicaid beneficiaries or to services provided under contract with the Department of Human Services, for example. It is also possible that CMS would take the position that taxing only providers of IDD residential services (and not providers of other types of residential services -- for example, assisted living, or group homes) would itself violate the "equal treatment" provision. This might depend on whether the intended taxpayers have the same or different license than other residential providers.

We are aware that the OIG has recently taken the position that the segregation of certain tax revenues (i.e., those coming from health care providers) may also constitute "different treatment," but to date CMS has not endorsed that view and we question whether it is correct, as the regulation speaks to different treatment of the taxpayer, not different treatment of the revenue generated from the tax.

In short, it may be possible to extend the transient lodging tax to include IDD residential providers, but the State would need to ensure that the treatment of all taxpayers is the same and that the State is not taxing a "subset" of residential providers. Because this is an area of the law that is still developing, and because the penalty of having a non-compliant tax is so steep, it may be advisable to discuss proposed legislation with CMS, once the State has a concrete proposal that it believes provides for equal treatment.

3. If the tax is a permissible tax, can DHS reimburse the cost of the tax to IDD providers?

Even if the State can extend the transient lodging tax to include IDD residential providers consistent with the above, there is one other issue that may prevent the State from achieving its goal of maximizing federal matching funds for IDD services.

Section 2493 of the State Medicaid Manual (SMM) makes a distinction between taxes imposed on the seller (which can be reimbursed as an expense under Medicaid) and those imposed on the consumer (which cannot be "passed on" to Medicaid). In 1989, the Departmental Appeals Board upheld a decision from CMS not to provide FFP for payments by a state Medicaid agency "of sales taxes which a recipient would otherwise have to pay," on the grounds that "there was no actual expenditure for medical assistance under the statute, since the state was in effect paying itself." Louisiana Dep't of Health and Hospitals, DAB No. 1109 (1989). While the SMM provision and the Appeals Board decision pre-date the rules on provider taxes, we believe CMS would continue to enforce this distinction.

We are not members of the Oregon bar and cannot opine on Oregon law, but we note that there does seem to be ambiguity in ORS 320.305 as to whether the transient lodging provider is the taxpayer, the tax collector, or both. *See* ORS § 320.305(1)(a) ("a tax of one percent is imposed on any consideration rendered for the . . . furnishing of transient lodging"); § 320.305(1)(c) (the tax shall be collected by the transient loding tax collector that receives the consideration); § 320.305(2) ("[t]he transient lodging tax collector may withhold a collection reimbursement charge of five percent of the amount collected"); § 330.330 ("the provisions apply to the taxpayer liable for the tax and to the transient lodging tax collector required to collect the tax . . . Any amount collected . . . is considered a tax upon the transient lodging tax collector required to collect the tax and the transient lodging tax collector is considered a taxpayer").

If the State wishes to proceed with making amendments to the transient lodging tax, we recommend that Oregon counsel provide an opinion as to whether further amendments need to be made to the statute to make clear that the tax is imposed on the transient lodging provider, and therefore can be reimbursed by the Medicaid program.

Please let me know if you have any questions regarding the foregoing.

Sincerely,

Caroline M. Brown