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# SENATE COMMITTEE ON BUDGET AND FISCAL REVIEW

Senator John Laird, Chair

2025 - 2026 Regular

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| <b>Bill No:</b>    | AB 125                | <b>Hearing Date:</b> | June 17, 2026 |
| <b>Author:</b>     | Committee on Budget   |                      |               |
| <b>Version:</b>    | June 12, 2026 Amended |                      |               |
| <b>Urgency:</b>    | No                    | <b>Fiscal:</b>       | Yes           |
| <b>Consultant:</b> | Scott Ogus            |                      |               |

**Subject:** Managed care organization tax

**Summary:** This bill assesses a tax on managed care organizations to: 1) comply with the new requirements imposed by House Resolution 1; 2) support the General Fund shortfall and achieve a balanced budget; 3) support Medi-Cal investments to ensure access, quality and equity; and 4) prevent the need for additional reductions in the Medi-Cal program.

**Background:** Federal Medicaid regulations allow states to impose provider-related taxes on health care service providers as long as certain conditions are met. The revenue from these taxes may serve as the non-federal share of spending for health care services in a state's Medicaid program, which allows the state to draw down additional federal funding for those services. State Medicaid programs may receive federal financial participation (FFP) for expenditures using health care-related taxes, as long as the taxes are broad-based, uniformly imposed, and contain no hold-harmless provisions.

In November 2024, voters approved Proposition 35, which made permanent a tax on enrollment of managed care organizations, and authorized expenditures to increase reimbursement rates in the Medi-Cal program, among other investments.

House Resolution (HR) 1 imposes significant additional limitations on the use of provider taxes that will have a significant impact on the state's financing of the overall Medi-Cal program and specific programs supporting provider reimbursements. HR 1 includes the following restrictions on provider taxes:

- 1) Prohibits new or increased provider taxes after enactment of the bill (July 4, 2025).
- 2) Phases down the indirect hold-harmless threshold, which serves as a de facto maximum level for the tax to comply with hold-harmless provisions of federal Medicaid regulations, from six percent of total revenues to 3.5 percent.
- 3) Revises criteria for "generally redistributive" taxes to exclude taxes that impose a higher rate on Medi-Cal providers or plans than on other providers or plans, similar to the structure of the current MCO tax.
- 4) Provides the federal Health and Human Services Secretary with discretion to provide a transition period for noncompliant taxes of up to three years.

The current MCO tax implemented under Proposition 35 would violate two provisions of HR 1: 1) the size of the tax as a percentage of total revenue would exceed the indirect hold harmless threshold when it phases down beginning October 1, 2027; and 2) the tax would not be “generally redistributive” because it taxes Medi-Cal managed care plans at a higher rate than other plans. According to the Department of Health Care Services (DHCS), the current MCO tax has received approval to remain in effect until the expiration of its original federal approval period, on December 31, 2026.

Provisions of Proposition 35 further complicate the future of the MCO tax under HR 1. The initiative requires the imposition of a substantially similar MCO tax to the one currently in effect, on and after January 1, 2027, when the original tax is scheduled to expire. The initiative also caps the annual tax liability of non-Medi-Cal plans at \$36 million. Because HR 1 requires a uniform level of tax between Medi-Cal and non-Medi-Cal plans, the tax liability cap of Proposition 35 limits the overall size of any future MCO tax because the size of the tax levied on Medi-Cal plans would be similarly limited.

**Proposed Law:** This bill assesses a tax on managed care organizations that complies with the requirements of HR 1, with the following provisions:

- 1) For calendar years 2027, 2028, and 2029, assesses a tax of \$8.85 per enrollee per month on managed care organizations licensed by the Department of Managed Health Care (DMHC) under the Knox-Keene Health Care Service Plan Act of 1975, or a managed care organization contracted with DHCS to provide health care services to Medi-Cal beneficiaries.
- 2) Establishes the Medi-Cal Stability Fund in the State Treasury to receive revenues from the tax on managed care organizations.
- 3) Continuously appropriates funds deposited in the Medi-Cal Stability Fund to DHCS to support the following Medi-Cal expenditures:
  - a. DHCS administrative costs, not to exceed \$4 million annually
  - b. The nonfederal share of increased capitation payments to Medi-Cal managed care plans, accounting for their increased tax obligations under the new tax on managed care organizations
  - c. The nonfederal share of increased targeted reimbursement rate increases for primary care, obstetrics, and non-specialty mental health providers
  - d. The nonfederal share of Medi-Cal managed care capitation payments, in the amount of at least \$2 billion annually.
- 4) Requires DHCS to seek approval from the federal Centers for Medicare and Medicaid Services (CMS) for imposition of the tax on managed care organizations.
- 5) Makes assessment of the tax on managed care organizations operative on January 1, 2027, or the effective date of any necessary federal approvals, whichever is later.
- 6) Authorizes DHCS, after consultation with affected stakeholders, to discontinue some or all of the directed payment methodologies for targeted provider rate increases for

primary care services, obstetrics services, and non-specialty mental health services once the equivalent level of reimbursement has been achieved in the base capitation rates for Medi-Cal managed care plans.

7) Deletes obsolete provisions related to community health workers.

**Fiscal Effect:** The tax on managed care organizations imposed by this bill will support the non-federal share of expenditures in the Medi-Cal program, resulting in General Fund savings of \$575 million in 2026-27, \$2.3 billion in 2027-28 and 2028-29, and \$1.7 billion in 2029-30.

**Support:** None on file.

**Opposed:** None on file.

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