

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**WE COULD NOT DETERMINE  
WHETHER WEST VIRGINIA'S  
SEVERANCE AND BUSINESS  
PRIVILEGE TAX ON BEHAVIORAL  
HEALTH SERVICES IS A PERMISSIBLE  
HEALTH-CARE-RELATED TAX**

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# *Office of Inspector General*

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## EXECUTIVE SUMMARY

*We could not determine whether West Virginia's Severance and Business Privilege Tax is a permissible health-care-related tax.*

### WHY WE DID THIS REVIEW

If certain requirements are met, States may tax health-care-related services and use those tax revenues to help fund their Medicaid programs. However, our May 2014 report on Pennsylvania's Gross Receipts Tax on Medicaid managed care organizations showed that State taxes on health-care-related services appeared to be a health-care-related tax that might not have been permissible for Medicaid funding. Our report recommended that the Centers for Medicare & Medicaid Services (CMS) clarify with all States its policy concerning permissible health-care-related taxes, and it did so.

Our objective was to determine whether West Virginia's Severance and Business Privilege Tax (Severance Tax) is a permissible health-care-related tax under Federal requirements.

### BACKGROUND

States are permitted to use tax revenues to finance the State's share of Medicaid expenditures. However, Federal law prohibits States from using tax revenues generated by impermissible health-care-related taxes to fund the State share of the Medicaid program. To determine if a tax is a permissible health-care-related tax, it must first be determined whether it is health care related. Federal laws and regulations identify a health-care-related tax as one that (1) is related to health care items or services or 85 percent or more of the tax burden falls on health care providers or (2) provides tax treatment to health care providers that is different from the tax treatment provided to other individuals or entities subject to the tax.

West Virginia's Severance Tax began in 1987 as a gross receipts tax on businesses that sever, extract, or produce natural resources within West Virginia. In 1993, West Virginia extended the Severance Tax to "all health care related services provided by a behavioral health center."

A tax that is not limited to health care items or services, such as the Severance Tax, may be considered a health-care-related tax if (1) at least 85 percent of the burden of the tax revenue falls on health care providers or (2) 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 subject to the tax.

If a tax is health care related, it must be permissible to be used to fund the State share of the Medicaid program. To be permissible, a health-care-related tax:

- must be broad based or apply to all services within a class,
- must be uniform in that all providers are taxed at the same rate, and

- must not allow arrangements that return the collected taxes directly or indirectly to the taxpayer (hold harmless arrangements).

## **WHAT WE FOUND**

We could not determine whether West Virginia’s Severance Tax is a permissible health-care-related tax. The Severance Tax does not place at least 85 percent of the tax burden on behavioral health services. We could not determine if the Severance Tax treats behavioral health services differently than the other items it taxes because the tax rates are not consistent and the proceeds from the tax on behavioral health services are placed in a fund different from the proceeds from the other items taxed. Citing privacy restrictions in its tax laws, West Virginia would not provide all the documents we needed to complete our analysis. We did not subpoena those records. Without this information, we could not identify the tax payers or validate the services being taxed. As a result, we could not determine if the Severance Tax is a health-care-related tax and, if it is, whether it is a permissible health-care-related tax.

We did determine that the West Virginia State Tax Department collected Severance taxes totaling \$65,734,933 from behavioral health centers for State fiscal years 2009 through 2013 and that this revenue was deposited into a restricted fund to pay State Medicaid expenses. By using its \$65,734,933 in tax revenue as the State share, West Virginia was able to draw \$233,755,839 in Federal funds to pay for \$299,490,772 in State Medicaid expenditures.

## **WHAT WE RECOMMEND**

We recommend that CMS:

- work with West Virginia to determine whether the Severance Tax is a permissible health-care-related tax and
- deduct the total amount of related tax revenues used to pay State Medicaid expenditures (\$65,734,933) and recalculate the Federal share, which we estimate to have been overpaid by \$50,631,106, if the Severance Tax is an impermissible health-care-related tax.

## **STATE AGENCY AND CMS COMMENTS AND OUR RESPONSE**

### **STATE AGENCY COMMENTS**

In its comments on our draft report, the State agency stated that, although it believes the tax is a valid non-health-care-related tax, it informed CMS that it will introduce legislation to remove behavioral health services from the Severance Tax, effective at the end of this State fiscal year ending June 30, 2016. The State agency anticipates that the bill will be enacted and will keep CMS apprised of any developments.

## **CMS COMMENTS**

CMS concurred with our first recommendation and stated that it had been informed by the West Virginia Department of Revenue that West Virginia is preparing legislation to be introduced in the next legislative session to remove behavioral health services providers from the Severance Tax effective June 30, 2016.

Regarding our second recommendation, CMS stated that it has made no official decision that the Severance Tax on behavioral health services was an impermissible health-care-related tax. CMS stated that, should West Virginia enact a tax structure consistent with CMS's July 2014 guidance by June 30, 2016, it will not devote further resources to investigate this issue and will not pursue any financial recoveries for periods before June 30, 2016.

## **OUR RESPONSE**

We will follow-up with CMS after June 30, 2016, to determine West Virginia's disposition of its Severance Tax on behavioral health services. If West Virginia submits a new proposal to tax these services, CMS should evaluate the proposal to determine if it is a permissible health-care-related tax. If West Virginia has not rescinded its Severance Tax on behavioral health services or modified it to conform to Federal statute and regulation by June 30, 2016, CMS should decide whether it is an impermissible health-care-related tax and make any required financial recoveries.

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## INTRODUCTION

### WHY WE DID THIS REVIEW

If certain requirements are met, States may tax health-care-related services and use those tax revenues to help fund their Medicaid programs. However, our report of May 2014 showed that State taxes on health-care-related services may not always meet these requirements.<sup>1</sup> Our report recommended that the Centers for Medicare & Medicaid Services (CMS) clarify with all States its policy concerning permissible health-care-related taxes, and it did so.

### OBJECTIVE

Our objective was to determine whether West Virginia's Severance and Business Privilege Tax (Severance Tax) is a permissible health-care-related tax under Federal requirements.

### BACKGROUND

#### Medicaid Program

The Medicaid program provides medical assistance to low-income individuals and individuals with disabilities. The Federal and State Governments jointly fund and administer the Medicaid program. At the Federal level, CMS administers the program. Each State administers its Medicaid program in accordance with a CMS-approved State plan. Although the State has considerable flexibility in designing and operating its Medicaid program, it must comply with applicable Federal requirements.

#### Health-Care-Related Taxes

States are permitted to use tax revenues to finance the State's share of Medicaid expenditures. However, Congress enacted the Medicaid Voluntary Contribution and Provider-Specific Tax Amendments of 1991 (Tax Amendment)<sup>2</sup> to address suspected State abuses of health-care-provider tax and donation programs. As a result, Federal law expressly prohibits States from using tax revenues generated by impermissible health-care-related taxes to fund the State share of the Medicaid program.

To determine if a tax is a permissible health-care-related tax, it must first be determined whether it is health care related. Federal law and regulations identify a health-care-related tax as one that (1) is related to health care items or services or where 85 percent or more of the tax burden falls on health care providers or (2) provides tax treatment to health care providers that is different from the tax treatment provided to other individuals or entities subject to the tax. If a tax is

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<sup>1</sup> *Pennsylvania's Gross Receipts Tax on Medicaid Managed Care Organizations Appears To Be an Impermissible Health-Care-Related Tax* (A-03-13-00201, issued May 28, 2014).

<sup>2</sup> Tax Amendments, P.L. No. 102-234 (Dec. 12, 1991) (codified at § 1903(w) of the Social Security Act (the Act)).

health care related, it must then be determined whether or not it is permissible. States are permitted to use revenues from permissible health-care-related taxes to finance the State's share of Medicaid expenditures.<sup>3</sup> Section 1903(w)(1)(A) allows health-care-related taxes provided they:

- are broad based or applied to all services within a class,
- are uniform in that all providers are taxed at the same rate,
- avoid hold harmless arrangements in which collected taxes are returned directly or indirectly to taxpayers.<sup>4</sup>

### **CMS Guidance for States' Health-Care-Related Taxes**

In response to the recommendations in our May 2014 report, CMS issued a letter in July 2014 to State Medicaid Directors and State Health Officials.<sup>5</sup> In that letter, CMS clarified that the 85-percent test does not establish a safe harbor for taxes that apply to both health care items and services and non-health care items and services. CMS also noted that taxing only a subset of a type of health care services or providers results in disparate treatment. The guidance instructed States with tax structures that did not meet the requirements to make necessary changes no later than the end of their next legislative sessions.

### **West Virginia's Health Care Provider Tax**

West Virginia's Health Care Provider Tax began in 1993 and initially taxed 16 health care services.<sup>6</sup> The revenue from the Health Care Provider Tax is deposited into a special revenue fund, the "Medicaid State Share Fund."

West Virginia did not include behavioral health services in its Health Care Provider Tax.

### **West Virginia's Severance and Business Privilege Tax**

Enacted in 1987, the Severance Tax is a gross receipts tax initially levied on businesses that sever, extract, or produce natural resource products within West Virginia. The natural resources include coal, limestone or sandstone, natural gas, and timber. In 1993, the Severance Tax was amended to impose a 5-percent tax "on persons providing behavioral health services, which

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<sup>3</sup> Section 1903(w) of the Act. The implementing regulations for section 1903(w) can be found at 42 CFR part 433, subpart B.

<sup>4</sup> 42 CFR § 433.68(b).

<sup>5</sup> State Health Official Letter SHO #14-001, issued July 25, 2014.

<sup>6</sup> West Virginia Code § 11-27.

include all health-care related services provided by a behavioral health center.”<sup>7</sup> Revenue from the Severance Tax on behavioral health services is deposited into the “Medicaid State Share Fund.” For tax years 2009 through 2013, the West Virginia State Tax Department collected a total of \$65,734,933 in Severance taxes from behavioral health centers.

## **HOW WE CONDUCTED THIS REVIEW**

Our review covered West Virginia’s Severance taxes from State fiscal years<sup>8</sup> 2009 through 2013. We analyzed the Federal and State requirements governing health-care-related taxes and how those requirements related to the West Virginia Severance Tax. West Virginia denied us access to tax records of behavioral health centers, citing privacy requirements in its tax law. We did not subpoena those records.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix A contains the details of our audit scope and methodology.

## **FINDING**

We could not determine whether West Virginia’s Severance Tax is a permissible health-care-related tax. The Severance Tax does not place at least 85 percent of the tax burden on behavioral health services. We could not determine if the Severance Tax treats behavioral health services differently than the other items it taxes because the tax rates are not consistent and the proceeds from the tax on behavioral health services are placed in a fund different from the proceeds from the other items taxed. Citing privacy restrictions in its tax laws, West Virginia would not provide all the documents we needed to complete our analysis. We did not subpoena those records. Without this information, we could not identify the taxpayers or validate the services being taxed. As a result, we could not determine if the Severance Tax is a health-care-related tax and, if it is, whether it is a permissible health-care-related tax.

## **FEDERAL AND STATE REQUIREMENTS**

States are permitted to use tax revenues to finance the State’s share of Medicaid expenditures. However, Federal law prohibits States from using tax revenues generated by impermissible health-care-related taxes to fund the State share of the Medicaid program. To determine if a tax is an impermissible health-care-related tax, it must first be determined whether it is health-care-related. Federal law and regulations state that a health-care-related tax is one that (1) is related to

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<sup>7</sup> West Virginia Code § 11-13A-2(d).

<sup>8</sup> West Virginia’s State fiscal years ends on June 30.

health care items or services or where 85 percent or more of the tax burden falls on health care providers or (2) provides tax treatment to health care providers that is different from the tax treatment provided to other individuals or entities.<sup>9</sup> States must reduce their claims for Federal reimbursement by the revenues collected from health-care-related taxes unless those taxes meet the requirements of a permissible health-care-related tax.<sup>10</sup>

Appendix B contains Federal and State requirements related to permissible health-care-related taxes.

**WE COULD NOT DETERMINE WHETHER WEST VIRGINIA’S SEVERANCE TAX IS A PERMISSIBLE HEALTH-CARE-RELATED TAX**

We could not determine whether West Virginia’s Severance Tax is a permissible health-care-related tax. The Severance Tax did not meet the first test to determine if it is health care-related because it is a tax on multiple different types of entities. In addition, less than 85 percent of Severance Tax revenue was collected from health care providers, as shown in the table below.

**Table: Severance Tax Revenue Collected From Behavioral Health Care Providers in West Virginia<sup>11</sup>**

	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
<b>Behavioral Health Tax Revenue</b>	\$10,506,203	\$11,689,338	\$12,065,558	\$14,946,707	\$16,527,127
<b>Total Severance Tax Revenue</b>	\$510,433,270	\$516,734,971	\$558,502,784	\$585,701,455	\$528,240,749
<b>Behavioral Health Tax Share</b>	2.1 percent	2.3 percent	2.2 percent	2.6 percent	3.1 percent

We could not determine if the Severance Tax met the second test to determine if it is a health-care-related tax. If West Virginia’s Severance Tax provides disparate tax treatment to health care providers, the Severance Tax would be a health-care-related tax and subject to Federal requirements. There are 10 items or services subject to the Severance Tax. Six of these items or services, including behavioral health services, are taxed at 5 percent. The remaining four items or service are taxed at lower rates between 1 percent and 2.5 percent.<sup>12</sup>

<sup>9</sup> 42 CFR § 433.55.

<sup>10</sup> 42 CFR §§ 433.57 and 433.68.

<sup>11</sup> Source: Tax Commission of West Virginia.

<sup>12</sup> Source: Tax Commissioner of West Virginia’s *Forty-Ninth Biennial Report*.

In addition, approximately 86 percent of the revenue generated by the Severance Tax collected from non-behavioral health providers is deposited in West Virginia's General Fund. The remaining revenue goes to local entities, the State Tax Department, and a State Infrastructure fund. Revenue from the Severance Tax on behavioral health service is deposited into the "Medicaid State Share Fund." Revenue from timber is also deposited into a special use fund for the State Division of Forestry. With the application of different tax rates and the placement of tax revenues in different funds, West Virginia may be providing different tax treatment to health care providers. If this was the case, the tax would be health-care-related and subject to the Federal health-care-related tax requirements.

Citing privacy restrictions in its tax laws,<sup>13</sup> West Virginia would not provide all the documents we needed to complete our analysis. We did not subpoena those records. Without this information, we could not identify the taxpayers or validate the services being taxed. As a result, we could not determine whether the Severance Tax is a health-care-related tax and, if it is, whether it is a permissible health-care-related tax.

We did determine that:

- the West Virginia State Tax Department collected Severance taxes totaling \$65,734,933 from behavioral health centers for State fiscal years 2009 through 2013,
- this revenue was deposited into a restricted fund to pay State Medicaid expenses, and
- revenues from the tax on behavioral health centers did not exceed 4 percent of total Severance Tax collections in any year of our audit period and therefore did not place at least 85 percent of the tax burden on behavioral health centers.

Because it used its \$65,734,933 in tax revenue as the State share, West Virginia was able to draw approximately \$233,755,839 in Federal funds to pay for \$299,490,772 in State Medicaid expenditures.

## RECOMMENDATIONS

We recommend that CMS:

- work with West Virginia to determine whether the Severance Tax is a permissible health-care-related tax and
- deduct the total amount of related tax revenues used to pay Medicaid expenditures (\$65,734,933) and recalculate the Federal share, which we estimated to have been overpaid by \$50,631,106, if the Severance Tax is an impermissible health-care-related tax.

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<sup>13</sup> West Virginia Code § 11-10-5(d).

## **STATE AGENCY AND CMS COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

### **STATE AGENCY COMMENTS**

In its comments on our draft report, the State agency stated that it believes the Severance Tax is not a health-care-related tax because it does not place at least 85 percent of the tax burden on behavioral health services. The State agency also stated that our draft report does not cite any facts to support the statement that the tax rates are not consistent. Finally, the State agency stated that the dedication of certain tax revenues does not mean that the tax is a health-care-related tax and that the segregation of revenues does not result in a different treatment of the taxpayer, only in different treatment of tax revenues. The State agency noted that this issue is not addressed by the regulation.

The State agency stated that, although it believes the tax is a valid non-health-care-related tax, it informed CMS that it will introduce legislation to remove behavioral health services from the Severance Tax, effective at the end of this State fiscal year ending June 30, 2016. The State agency anticipates that the bill will be enacted and will keep CMS apprised of any developments.

### **CMS COMMENTS**

CMS concurred with our first recommendation and stated that it had been informed by the West Virginia Department of Revenue that West Virginia is preparing legislation to be introduced in the next legislative session to remove behavioral health services providers from the Severance Tax effective June 30, 2016.

Regarding our second recommendation, CMS stated that it has made no official decision that the Severance Tax on behavioral health services was an impermissible health-care-related tax. CMS stated that, should West Virginia enact a tax structure consistent with CMS's July 2014 guidance by June 30, 2016, it will not devote further resources to investigate this issue and will not pursue any financial recoveries for periods before June 30, 2016.

### **OFFICE OF INSPECTOR GENERAL RESPONSE**

#### **To West Virginia's Comments**

West Virginia is incorrect in its assertion that the current tax is not a health-care-related tax because less than 85 percent of its revenues are generated from behavioral health services. As was stated in the July 2014 CMS letter to State Medicaid Directors and State Health Officials, "this provision [less than 85 percent] does not establish a safe harbor for any tax on health care providers that falls below the threshold." Secondly, the tax rates we identified in the report are correct and were identified in the Tax Commissioner of West Virginia's *Forty-Ninth Biennial Report*. To determine if a health-care-related tax is permissible, we need to know if all providers of behavioral health services are taxed and that they are all taxed at the same rate. Because we did not have access to that information, we could not make that determination. Lastly, we did

not make a determination about whether the disposition of behavioral health services tax revenue into a restricted fund constitutes disparate treatment.

### **To CMS's Comments**

We will follow up with CMS after June 30, 2016, to determine West Virginia's disposition of its Severance Tax on behavioral health services. If West Virginia submits a new proposal to tax these services, CMS should evaluate the proposal to determine if it is a permissible health-care-related tax. If West Virginia has not rescinded its Severance Tax on behavioral health services or modified it to conform to Federal statute and regulation by June 30, 2016, CMS should decide whether it is an impermissible health-care-related tax and make any required financial recoveries.

## **APPENDIX A: AUDIT SCOPE AND METHODOLOGY**

### **SCOPE**

For tax years 2009 through 2013, West Virginia collected \$2.1 billion in Severance taxes. This included \$65,734,933 collected from behavioral health centers. Our review was based on an analysis of the Federal and State requirements and applying those requirements to the Severance Tax on behavioral health centers. West Virginia denied us access to tax records of behavioral health centers, citing privacy requirements in its tax law. We did not subpoena those records.

We did not review the overall internal control structure of West Virginia or the Medicaid program. Rather, we reviewed only those internal controls related to our objective. We limited our review to determining whether West Virginia's Severance Tax is an impermissible health-care-related tax. We did not extend our review to any other health-care-related tax in West Virginia.

We conducted our audit from May 2012 to April 2014 and performed our fieldwork at the State agency's office in Charleston, West Virginia.

### **METHODOLOGY**

To accomplish our objective, we:

- reviewed applicable Federal statutes and regulations on health-care-related taxes,
- reviewed West Virginia's statutes implementing its Severance Tax program,
- reviewed data provided by West Virginia concerning Severance Tax collections for the audit period,
- held discussions with State agency officials to gain an understanding of the operation of the Severance Tax, and
- met with CMS and West Virginia officials to discuss our finding and recommendations.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## **APPENDIX B: FEDERAL AND STATE REQUIREMENTS**

### **FEDERAL LAWS AND REGULATIONS**

#### **Permissible Health-Care-Related Taxes and the Services They Cover**

The Medicaid Voluntary Contribution and Provider Specific Tax Amendments of 1991 amended the Act by adding section 1903(w), which relates to permissible donations and health-care-related provider taxes.

Federal law and regulations state that a health-care-related tax is one that (1) is related to health care items or services or where 85 percent or more of the tax burden falls on health care providers or (2) provides tax treatment to health care providers that is different from the tax treatment provided to other individuals or entities (1903(w)(3)(A) and 42 CFR § 433.55). A health-care-related tax is permissible if the tax:

- is broad based or applied to all services within a class,
- is uniform in that all providers are taxed at the same rate, and
- does not violate hold harmless provisions.<sup>14</sup>

#### **CMS Guidance for Health-Care-Related Taxes**

CMS issued a letter in July 2014 to State Medicaid Directors and State Health Officials.<sup>15</sup> In that letter, CMS clarified how to determine whether a tax is considered a health-care-related tax. CMS stated:

In determining whether a tax is related to health care items or services, section 1903(w)(3)(A) also specifies that if 85 percent of the tax burden falls on health care providers, it is considered to be related to health care items or services. However, this provision does not establish a safe harbor for any tax on health care providers that falls below the threshold. 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.

In the same letter, CMS stated that:

Taxing a subset of health care 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

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<sup>14</sup> 42 CFR § 433.68(b).

<sup>15</sup> SHO #14-001, July 25, 2014.

MCOs [Managed Care Organizations]), since the providers or users of those health care services are being treated differently than others who are not within the specified universe.

## **WEST VIRGINIA CODE**

### **West Virginia Code § 11-13A-3(a)**

*Imposition of tax.*—Upon every person exercising the privilege of engaging or continuing within this state in the business of severing, extracting, reducing to possession and producing for sale, profit or commercial use coal, limestone or sandstone, or in the business of furnishing certain health care services, there is hereby levied and shall be collected from every person exercising such privilege an annual privilege tax.

### **West Virginia Code § 11-13A-3(c)**

“ *Certain health care services* ” *defined.*—For purposes of this section, the term “certain health care services” means, and is limited to, behavioral health services.”

### **West Virginia Code § 11-13A-2(d)**

*Specific definitions for persons providing health care items or services*—  
“Behavioral health services” means services provided for the care and treatment of persons with mental illness, mental retardation, developmental disabilities or alcohol or drug abuse problems in an inpatient, residential or outpatient setting, including, but not limited to, habilitative or rehabilitative interventions or services and cooking, cleaning, laundry and personal hygiene services provided for such care: *Provided,* That gross receipts derived from providing behavioral health services that are included in the provider’s measure of tax ... shall not be include[ed] in that provider’s measure of tax under this article.

### **West Virginia Code § 11-10-5d(a)**

*General rule.*—Except when required in an official investigation by the Tax Commissioner ..., it shall be unlawful for any officer, employee or agent of this state or of any county, municipality or governmental subdivision to divulge or make known in any manner the tax return, or any part thereof, of any person or disclose information concerning the personal affairs of any individual or the business of any single firm or corporation....

## APPENDIX C: STATE AGENCY COMMENTS



### STATE OF WEST VIRGINIA DEPARTMENT OF HEALTH AND HUMAN RESOURCES

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Re: Report Number A-03-14-00200

Dear Mr. Virbitsky:

Thank you for the opportunity to provide comment on the draft report entitled *We Could Not Determine Whether West Virginia's Severance and Business Privilege Tax on Behavioral Tax Services is a Permissible Health-Care-Related Tax*, No. A-03-14-00200.

We believe the Severance and Business Privilege Tax is not a health-care-related tax. As the draft report points out, the Severance and Business Privilege tax does not place at least eight-five percent (85%) of the tax burden on behavioral health services. Therefore it does not meet the definition of a health-care related tax in *42 C.F.R. § 433.55(b)*.

The draft report also states that your office could not determine if the Severance and Business Privilege tax treats behavioral health services differently than the other items it taxes because the tax rates are not consistent and the proceeds from the tax on behavioral health services are placed in a fund different from the proceeds from the other items taxed. The report does not cite any facts to support the statement that the tax rates are not consistent. The tax established by statute is five percent (5%) of the gross value of the natural resource produced or the health care service provided. *W.V. Code § 11-13A-3(b)*.

The dedication of certain revenues does not mean that the tax is a health-care related tax. *42 C.F.R. § 433.55(c)* provides that a tax may be considered health-care related if the "treatment of individuals or entities providing or paying" for the health care services is different than the "tax treatment provided to other individuals or entities." The segregation

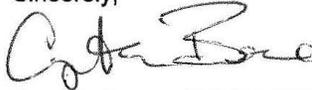
Stephen Virbitsky  
November 13, 2015  
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of revenues does not result in a different treatment of the taxpayer, only in different treatment of tax revenues, which is not addressed by the regulation.

While we believe our tax is a valid, non-health care-related tax, we have informed the Centers for Medicare & Medicaid Services ("CMS") that legislation will be introduced in the next legislative session to remove behavioral health service provided from the Severance and Business Privilege Tax, effective at the end of this state fiscal year. We anticipate that the bill will be enacted, and will keep CMS apprised of any developments.

Thank you for the opportunity to respond to the draft report.

Sincerely,



Cynthia Beane, MSW, LCSW  
Acting Commissioner

CB/RS/ko

## APPENDIX D: CMS COMMENTS



DEPARTMENT OF HEALTH & HUMAN SERVICES

Centers for Medicare & Medicaid Services

OCT 16 2015

200 Independence Avenue SW  
Washington, DC 20201

**TO:** Daniel R. Levinson  
Inspector General

**FROM:** Andrew M. Slavitt *Andrew M. Slavitt*  
Acting Administrator

**SUBJECT:** Office of Inspector General (OIG) Draft Report: "We Could Not Determine Whether West Virginia's Severance and Business Privilege Tax on Behavioral Health Services Is a Permissible Health-Care-Related Tax" (A-03-14-00200)

The Centers for Medicare & Medicaid Services (CMS) appreciates the opportunity to review and comment on the Office of Inspector General's (OIG) draft report. CMS is committed to making sure that States fund their Medicaid programs through permissible sources.

Section 1903(w)(3)(A)(i) of the Social Security Act defines a health-care-related tax using multiple tests that must be applied. Health-care-related taxes include taxes related to: (1) health care items or services; (2) the provision of, or the authority to provide, the health care items or services; or (3) payment for such items or services. Section 1903(w)(3)(A)(ii) further stipulates that a health-care-related tax includes taxes that are not limited to health care items or services, but provide for different or unequal treatment for individuals or entities that are paying for or providing health care items or services. Any tax must be fully evaluated against all components of the statutory definition.

The statute further stipulates that if 85 percent of the tax burden falls on health care providers, it is considered to be related to health care items or services; however, this provision does not state the converse is true—that if less than 85 percent of the burden falls on health care providers, it is not necessarily related to health care items and services. CMS issued guidance to states in July 2014 to clarify what would or would not be considered a health-care-related tax and in light of this guidance advised states that may have non-permissible health-care-related taxes to make any changes necessary to achieve compliance as soon as feasible.

As the OIG notes in their draft report, West Virginia's Severance and Business Privilege Tax began as a gross receipts tax on businesses that produce natural resources within the State. In 1993, West Virginia extended this tax to all health care related services provided by a behavioral health center. West Virginia State Tax Department collected Severance Taxes totaling \$65,734,933 from behavioral health centers for State fiscal years 2009-2013 and used these funds to pay State Medicaid expenses.

In June 2015, CMS raised concerns with West Virginia regarding the inclusion of behavioral health care services into the Severance Tax. We indicated that we had concerns that the tax on behavioral health care services appeared to be health care related and may not be permissible under federal statute and regulation. As a result, West Virginia has decided to prepare legislation

to be introduced in the next legislative session to remove behavioral health service providers from the Severance and Business Privilege Tax, effective at the end of this state fiscal year (June 30, 2016).

OIG's recommendations and CMS' responses are below.

**OIG Recommendation**

The OIG recommends that CMS work with West Virginia to determine whether the Severance Tax is a permissible health-care-related tax

**CMS Response**

CMS concurs with this recommendation. The West Virginia Department of Revenue has informed CMS that they are preparing legislation to be introduced in the next legislative session to remove behavioral health service providers from the Severance Tax, effective June 30, 2016.

**OIG Recommendation**

The OIG recommends that CMS deduct the total amount of related tax revenues to pay State Medicaid expenditures (\$65,734,933) and recalculate the Federal share, which we estimate to have been overpaid by \$50,631,106, if the Severance Tax is an impermissible health-care-related tax.

**CMS Response**

CMS has made no finding that the Severance Tax, as applied to behavioral health providers, is an impermissible health-care-related tax. CMS issued guidance to states in July 2014 to clarify what would or would not be considered a health-care-related tax and in light of this guidance advised states that may have non-permissible health-care-related taxes to make any changes necessary to achieve compliance as soon as feasible, but no later than the end of their next legislative session. Consistent with the July 2014 guidance, West Virginia has committed to correct this issue effective June 30, 2016. Should the State enact an approvable tax structure within this timeframe, CMS will not devote further resources to investigate the issue and will not pursue any financial recoveries for periods prior to June 30, 2016.