Briefing Memorandum

To: Board of Managers

From: Jonny F. Hipp, Administrator/CEO

Date: September 22, 2026

Subject: CMS Withholding of Texas Medicaid Directed & Supplemental Payments

---

1. Bottom Line Up Front

Since **September 1, 2026** (start of Texas's FY2027), CMS has withheld approval of roughly **$9.8 billion** in Texas Medicaid state-directed and supplemental payment programs — most of it tied to the **Comprehensive Hospital Increase Reimbursement Program (CHIRP)**. Texas hospitals are reportedly losing about **$27 million a day** as a result. The dispute centers on how local Texas taxing entities calculate the hospital "provider taxes" used to draw down federal matching funds, not on a new legal ruling — it follows a separate case Texas *won* against CMS in 2025 over a related but distinct "hold harmless" issue. Gov. Abbott has pushed back publicly and calls it a funding "gun to the head"; CMS says it is protecting the integrity of Medicaid financing.

---

2. Background: How the Money Normally Works

- Texas Medicaid payments to providers fall into three buckets: **base payments** (fee-for-service/managed care claims), **supplemental payments**, and **directed payments** (authorized under 42 CFR §438.6(c), which let the state direct Medicaid managed-care organizations to pay providers more for specific goals).
- **CHIRP** is the largest of these programs. Local governmental entities (counties, hospital districts) collect roughly **$4 billion/year** in local hospital taxes; the federal government matches those dollars, and the combined funding flows back to hospitals through Medicaid managed-care organizations to close the gap between what Medicaid pays and what care actually costs.
- Federal law requires these "provider taxes" to be **broad-based** (applied to all providers in a class) and **uniform** (same rate for all), and prohibits **"hold harmless" arrangements** that guarantee providers get their tax money back.

3. The Current Dispute (Fall 2026)

- CMS began questioning Texas's local hospital-tax calculation methodology in **December 2025** and said it would withhold approval of the affected payment programs until Texas addressed its concerns.
- Texas has gone through **11 rounds of CMS information requests**, including an August demand that Texas certify none of the funding covers care for people without verified immigration status — Texas HHSC provided that assurance on **August 17, 2026**.
- No resolution was reached before the FY2027 start, so as of **September 1, 2026**, CMS is withholding approval for **three state-directed/supplemental payment programs**, the bulk of it CHIRP-related — a total Texas pegs at **up to $12 billion** for the year (THA's more conservative running estimate is **$9.8B**).
- This is not the first time Texas has fought CMS over this funding, and Texas previously prevailed in a similar dispute in 2023 — though the One Big Beautiful Bill Act (OBBBA) has since reshaped federal Medicaid financing rules nationally.

4. Financial/Service Impact Reported by Hospitals

- Texas hospitals are losing an estimated $27 million per day.

- Harris Health (Houston's public hospital system) projects a loss of **at least $258 million**; total Houston-region exposure estimated as high as **$1.4 billion**.
- Children's Health in Dallas has warned that continued delays threaten pediatric specialty and behavioral-health access.
- THA leadership has said there is no state general-revenue cushion available to offset the federal shortfall.
- Even with a near-term federal/state agreement, hospitals reportedly expect **90+ days** to clear resulting claims backlogs.

5. Political Positioning

- **Gov. Greg Abbott** wrote HHS Secretary **Robert F. Kennedy Jr.** on **August 7, 2026**, defending the tax structure as fully compliant with federal law, calling the delay an economic "gun to the head," and putting the state's potential 2027 loss at up to $12 billion.
- Abbott has said Texas is willing to *voluntarily* adjust its tax structure going forward to satisfy CMS, but wants federal assurance that doing so won't be treated as an admission the current system is unlawful, and wants guarantees the state won't lose the "grandfathered" protections he says OBBBA provides for existing tax structures.
- Abbott's letter states the tax structure enacted by the Texas Legislature and implemented daily by local governments fully complies with federal law, and that CMS's request undermines protections recently enacted in the One Big Beautiful Bill Act.
- CMS's public position is that it is reviewing Texas's financing structure for compliance and to protect Medicaid's financial integrity; Texas officials maintain their calculation methodology hasn't changed and remains compliant.

6. Legal/Regulatory Context (related but distinct threads)

It's worth separating **two related CMS-Texas fights** that are sometimes conflated in coverage:

A. The hold-harmless/final-rule litigation (Texas won this one)

- Texas sued CMS in **April 2023** over a CMS informational bulletin that expanded the definition of prohibited "hold harmless" arrangements to reach private redistribution agreements among providers.
- CMS's **April 2024 Medicaid managed-care final rule** codified related financing/appeals provisions Texas hospitals opposed; Texas amended its suit to challenge that rule too (May 2024).
- **September 24, 2025**: The U.S. District Court for the Eastern District of Texas (Texas v. CMS, No. 6:23-cv-00161) permanently vacated CMS's reinterpretation, finding CMS exceeded its statutory authority, and applied the vacatur **nationwide**, not just to Texas.
- CMS appealed; the case (*State of Texas et al. v. Oz and CMS et al.*, No. 25-40766) is now before the **Fifth Circuit**. Hospital associations (THA, America's Essential Hospitals, and others) filed amicus briefs in June 2026 supporting the district court's nationwide vacatur.

B. The current SFY2027 payment-withholding dispute (unresolved, described in Sections 2–5)

- This is a **separate, ongoing administrative dispute** over provider-tax calculation methodology, not (yet) new litigation, though it draws on the same underlying statutory framework (broad-based/uniform tax requirements, hold-harmless prohibitions).
- **OBBBA** (2025) independently caps state-directed payment rates — 100% of Medicare for Medicaid-expansion states, **110% of Medicare for non-expansion states like Texas** — which constrains what Texas can pay through CHIRP-type programs regardless of how the tax-methodology dispute resolves.

7. Precedent to Watch

- **Florida** faced a similar CMS challenge to its hospital tax structure; that dispute took **11 months** to resolve.
- Analysts (AJMC) flag this as evidence the Texas standoff could run long even if an in-principle agreement is reached soon, given claims-processing lag time.

8. Open Questions / Things to Monitor

- Whether Texas and CMS reach a negotiated fix to the tax-calculation methodology (and on what timeline).
- Whether CMS releases any of the withheld $9.8–12B once/if Texas's methodology changes are accepted, and whether that release is retroactive to September 1.
- Fifth Circuit ruling in the separate hold-harmless appeal, which could affect CMS's leverage/authority nationally.
- Further immigration-status certification requirements CMS may impose as a condition of approval.
- State legislative or emergency funding response if the standoff continues into 2027.

# # #