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# Premium Tax Credits and Federal Health Insurance Exchanges: Questions and Answers

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## Summary

Legal challenges that may have a substantial impact on the implementation and operation of the Patient Protection and Affordable Care Act (ACA) concern whether premium tax credits are available for millions of individuals participating in federally administered health insurance exchanges. These credits, which became available in 2014, are intended to help individuals pay the premiums for private health plans offered through the insurance exchanges established under the act. In addressing who may receive this credit, ACA refers to individuals who are “enrolled in [a plan] through an exchange established by the State” under ACA. Following the issuance of IRS regulations that allow for these credits to be available in both state and federally run exchanges, lawsuits were filed claiming that the language of ACA prohibits the credits from being available to individuals who obtain coverage in federally run exchanges. The Supreme Court is currently reviewing this issue in *King v. Burwell*. The Court heard oral arguments in the *King* case on March 4, 2015, and a decision is expected by the end of the Court’s term in June 2015 at the latest.

This report provides background on provisions of ACA relevant to this issue. It then answers questions concerning the legal challenges and potential implications of the Court’s decision in *King*.

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## Introduction

In March 2015, the Supreme Court heard oral arguments in *King v. Burwell*,<sup>1</sup> a case addressing an important issue of implementation of the Patient Protection and Affordable Care Act (ACA).<sup>2</sup> The lawsuit involves the provision of premium tax credits, which became available in 2014 and are intended to help certain individuals pay their premiums for private health insurance plans offered through insurance “exchanges” established under ACA.<sup>3</sup> At issue in *King* and other similar legal challenges is whether the statutory language of ACA allows the IRS to provide these credits to residents of states that declined to establish health insurance exchanges, where the state’s exchange is instead facilitated by the federal government. The issue is considered a significant one, given that the majority of states have a federally facilitated exchange,<sup>4</sup> and millions of individuals receive these credits in order to assist with the purchase of health insurance. This report provides background on relevant provisions of ACA. It then answers questions concerning the litigation and potential implications of the Court’s decision in *King*.

## I. Background

As part of ACA’s intended goal of improving accessibility to health coverage, the act provides for the establishment of “exchanges,” structured marketplaces for the sale and purchase of health insurance.<sup>5</sup> Section 1311 of ACA specifies that each state must establish an American Health Benefit exchange that is either a state governmental agency or a nonprofit entity, in order to provide health coverage to qualified individuals and employers.<sup>6</sup> However, a separate section of ACA, Section 1321, generally provides that if a state does not elect to establish an exchange, or if the Secretary of Health and Human Services (HHS) determines that an electing state will not have an operational exchange, or has not taken certain specified actions, the Secretary must establish and operate such exchange within the state.<sup>7</sup>

In order to assist individuals in purchasing health insurance in an exchange, Section 36B of the Internal Revenue Code, created by ACA, provides that certain lower and moderate-income taxpayers may receive a refundable tax credit that is intended to help pay the cost of the health insurance premium.<sup>8</sup> A taxpayer may claim the credit at the end of the year when filing an income

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<sup>1</sup> 759 F.3d 358, (4<sup>th</sup> Cir. 2014), *cert. granted*, 83 U.S.L.W. 3286 (U.S. November 7, 2014) (No. 14-114).

<sup>2</sup> P.L. 111-148 (2010). ACA was amended by the Health Care Education and Reconciliation Act (HCERA) of 2010, P.L. 111-152 (2010). These acts will be collectively referred to in this report as “ACA.”

<sup>3</sup> 26 U.S.C. §36B. Exchanges are also referred to as “marketplaces.” *See, e.g.*, Department of Health and Human Services, The Center for Consumer Information & Insurance Oversight, Health Insurance Marketplaces, *available at* <http://www.cms.gov/CCIIO/Programs-and-Initiatives/Health-Insurance-Marketplaces/index.html>.

<sup>4</sup> For more information, *see* footnotes 82-85 and accompanying text.

<sup>5</sup> P.L. 111-148, §1301 et seq. (codified at 42 U.S.C. §18021 et seq.).

<sup>6</sup> 42 U.S.C. §18031(b)(1), (d)(1). ACA also provides for the creation of small business health option program (SHOP) exchanges that are directed at the small group market. These exchanges will not be addressed in this report. For more information on SHOP, *see* CRS Report R43771, *Small Business Health Options Program (SHOP) Exchange*, by (name redacted).

<sup>7</sup> P.L. 111-148, §1321(e) (codified at 42 U.S.C. §18041(e)).

<sup>8</sup> 26 U.S.C. §36B.

tax return or claim an estimated credit during the year in the form of advance payments made directly to the insurer and applied towards the premium.<sup>9</sup>

In general, there are two principal factors that affect whether a taxpayer will be eligible for a premium tax credit: (1) whether the taxpayer meets the income and other requirements for the credit,<sup>10</sup> and (2) whether any months during the taxable year qualify as “coverage months” for the taxpayer. With respect to this second requirement, in order for a taxpayer to receive a health insurance premium credit under ACA, at least one month in the year must qualify as a coverage month for the taxpayer.<sup>11</sup> The term “coverage month” in Section 36B means the following:

[W]ith respect to an applicable taxpayer, any month if—

(i) as of the first day of such month the taxpayer, the taxpayer’s spouse, or any dependent of the taxpayer is covered by a qualified health plan ... *enrolled in through an exchange established by the State under section 1311 of the Patient Protection and Affordable Care Act ...*<sup>12</sup>

In addition, the amount of the premium tax credit is equal to the sum of the “premium assistance credit amount” for each coverage month the taxpayer experiences during the taxable year. The premium assistance credit amount is defined as the amount equal to the lesser of

(A) the monthly premiums for such month for 1 or more qualified health plans offered in the individual market within a State which cover the taxpayer, the taxpayer’s spouse, or any dependent ... of the taxpayer *and which were enrolled in through an exchange established by the State under 1311 of the Patient Protection and Affordable Care Act*, or

(B) the excess (if any) of—

(i) the adjusted monthly premium for such month for the applicable second lowest cost silver plan with respect to the taxpayer, over

(ii) an amount equal to 1/12 of the product of the applicable percentage and the taxpayer’s household income for the taxable year.<sup>13</sup>

<sup>9</sup> 42 U.S.C. §18082. When filing their income tax returns at the end of the year, taxpayers who claimed an estimated credit must calculate the amount of credit they are actually due and then reconcile that amount with the amounts received as advanced payments—this will then affect the size of their refund or tax owed. 26 U.S.C. §36B(f).

<sup>10</sup> In order to be eligible for a premium credit, a taxpayer’s household income must be between 100% and 400% of the federal poverty line (FPL) for the taxpayer’s family size. 26 U.S.C. §36B(c)(1). Individuals with income below 100% of the FPL are ineligible for a premium credit, but may qualify for assistance under Medicaid. An exception is made for lawfully present aliens with income below 100% of the FPL, who are ineligible for Medicaid on account of their alien status. 26 U.S.C. §36B(e). These taxpayers will be treated as though their income is exactly 100% of FPL for purposes of the credit.

<sup>11</sup> 26 U.S.C. §36B(b)(1). Any month during which an individual is eligible for other minimum essential coverage would not be counted as a coverage month. Examples of other minimum essential coverage include, but are not limited to, affordable employer provided coverage, Medicare, and Medicaid.

<sup>12</sup> 26 U.S.C. §36B(c)(2) (emphasis added).

<sup>13</sup> 26 U.S.C. §36B(b)(2)(A)-(B) (emphasis added). It should be noted that the reference to the “silver plan” in subsection (B) refers to one that is offered in the “same exchange” as plans described in subsection (A). 26 U.S.C. §36B(b)(3)(B).

Following passage of ACA, it was argued that, based on this language in Section 36B (i.e., “an exchange established by the State under section 1311 of [ACA],”) premium tax credits are not available to taxpayers in exchanges created by the federal government.<sup>14</sup> In May 2012, the Internal Revenue Service (IRS) issued final regulations related to the premium tax credit that make the credits available to taxpayers who obtain coverage in both state and federally facilitated exchanges.<sup>15</sup> The preamble to the regulations explains the IRS’s position that the statutory language of Section 36B supports this interpretation, and states that “the relevant legislative history does not demonstrate that Congress intended to limit the premium tax credit to State exchanges,” and that this reading of the language of Section 36B “is consistent with the language, purpose, and structure of section 36B and the Affordable Care Act as a whole.”<sup>16</sup> After issuance of the regulations, at least four lawsuits were filed against the Administration, claiming the IRS overstepped its authority when it made these credits available to individuals in states that have the federal government run their exchanges.

### **How does the premium tax credit interact with the individual and employer mandates?**

In order to understand some key aspects of the *King* case and other litigation, it is helpful to look at how ACA’s individual and employer mandates interact with the premium tax credit. Under ACA, beginning in 2014, certain individuals must have “minimum essential” health coverage or be subject to a tax penalty.<sup>17</sup> This is known as the individual mandate. There is an exemption for individuals whose contribution to health coverage is more than 8% of their household income.<sup>18</sup> ACA specifies that this contribution is calculated for certain individuals as the annual premium for the lowest cost plan available on an exchange in the state, minus any allowable premium tax credit.<sup>19</sup> Accordingly, if an individual is not allowed the premium credit, coverage becomes more expensive and the unaffordability exemption may kick in, meaning that the individual does not have to obtain coverage under the individual mandate. ACA also includes shared responsibility requirements for employers, commonly referred to as the employer mandate.<sup>20</sup> The employer mandate imposes a tax on “large employers” that do not offer health insurance to their employees or offer coverage that fails to meet certain affordability and adequacy standards.<sup>21</sup> ACA specifies that liability for the tax is generally triggered when at least one of an employer’s full-time

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<sup>14</sup> See generally, New York Times, Lawyer Put Health Act in Peril by Pointing Out 4 Little Words, March 2, 2015, available at [http://www.nytimes.com/2015/03/03/us/politics/in-four-word-phrase-challenger-spied-health-care-laws-vulnerability.html?\\_r=0](http://www.nytimes.com/2015/03/03/us/politics/in-four-word-phrase-challenger-spied-health-care-laws-vulnerability.html?_r=0); Wall Street Journal, Health Law Opponents Challenge Tax Credit, July 16, 2012, available at <http://online.wsj.com/article/SB10001424052702303933704577531271643114572.html>.

<sup>15</sup> Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, 77 *Federal Register* 30377 (May 23, 2012).

<sup>16</sup> *Id.* at 30378.

<sup>17</sup> 26 U.S.C. §5000A. For background on the individual mandate, see CRS Report R41331, *Individual Mandate Under ACA*, by (name redacted).

<sup>18</sup> 26 U.S.C. §5000A(e)(1).

<sup>19</sup> 26 U.S.C. §5000A(e)(1)(B)(ii) (emphasis added).

<sup>20</sup> 26 U.S.C. §4980H. For more information on the employer mandate, see CRS Report R41159, *Potential Employer Penalties Under the Patient Protection and Affordable Care Act (ACA)*, by (name redacted).

<sup>21</sup> Implementation of the employer mandate is being phased in. Beginning in 2015, employers with at least 100 full-time equivalent (FTEs) workers will be subject to these requirements. In 2016, employers with at least 50 FTEs will have to comply. To facilitate administration of these requirements, employers will report information (such as number of employees and health plan information) to the IRS, beginning in 2015.

employees is allowed a premium tax credit through a health insurance exchange.<sup>22</sup> Accordingly, if credits are not available in states with federally run exchanges, large employers may not be subject to penalties if they fail to offer affordable coverage to employees.<sup>23</sup>

## II. Litigation over Premium Tax Credits and Federally Facilitated Exchanges

### What are some of the arguments made for and against whether the statutory text of ACA permits premium tax credits in federally facilitated exchanges?

Challengers of the IRS regulations and certain legal commentators primarily argue that the plain language of ACA is clear: receipt of a premium tax credit under ACA depends upon whether a taxpayer was enrolled “through an exchange *established by the State under section 1311* of the [ACA].”<sup>24</sup> According to the litigants, the federal government is not a “state,” and therefore, the IRS cannot extend these credits to individuals participating in federally facilitated exchanges.<sup>25</sup> Further, it has been asserted that if this phrase is interpreted to encompass both state and federally facilitated exchanges, the words “established by the state” serve no purpose, and this violates a basic principle of statutory interpretation that statutes should be construed to give effect “to all its provisions, so that no part will be inoperative or superfluous, void or insignificant....”<sup>26</sup> Challengers also assert that the federal government’s authority to establish exchanges comes from Section 1321 of ACA, not Section 1311.<sup>27</sup> Had Congress wanted to provide premium tax credits to state and federally established exchanges, they argue, it could have clearly said so by referencing this section of the act.<sup>28</sup>

Challengers and commentators also contend that it is at least “plausible” that Congress intended to limit premium tax credits to state-run exchanges.<sup>29</sup> It is claimed that in passing ACA, Congress wanted states to create their own exchanges, but that it could not compel states to do so without violating federalism principles under the Tenth Amendment. Accordingly, Congress used a carrot and stick approach: it incentivized the states to take action by conditioning the availability of credits upon whether a state established an exchange.<sup>30</sup>

Conversely, the Administration and others have argued that the challengers rely on the phrase, “an exchange established by the State,” in isolation, and this leads to a flawed interpretation of the

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<sup>22</sup>26 U.S.C. §4980H(b).

<sup>23</sup> However, an employer may still potentially be subject to tax if the employer has a place of business in a state with a federal exchange, but employs individuals who reside in a different state that has a state-run exchange.

<sup>24</sup>*See, e.g.*, Petition for Certiorari, at 24-25, *King v. Burwell* (No. 14-114).

<sup>25</sup> *See, e.g.*, *King*, 759 F.3d at 368; *Halbig v. Burwell*, 758 F.3d 390, 398 (D.C. Cir. 2014). *See also* 42 U.S.C. §18024(d) (defining “State” to “mean[] each of the 50 States and the District of Columbia”).

<sup>26</sup> *See, e.g.*, *Hibbs v. Winn*, 542 U.S. 88, 101 (2004). *See also* Petition for Certiorari, at 25, *King v. Burwell* (No. 14-114), citing *Duncan v. Walker*, 533 U.S. 167, 174 (2001).

<sup>27</sup> *See, e.g.*, *King*, 759 F.3d at 368.

<sup>28</sup> *See also* Petition for Certiorari, at 25, *King v. Burwell* (No. 14-114), citing *Custis v. United States*, 511 U.S. 485, 492 (1994).

<sup>29</sup> *Id.* at 32.

<sup>30</sup> *Id.* at 14. *See also* Brief of Appellants, *Halbig v. Burwell*, No. 14-5018 (D.C. Cir. October 3, 2014) (en banc) at 2-5.

act. According to the government, the text of ACA as a whole makes clear that premium tax credits are available on all exchanges.<sup>31</sup> For example, the government notes that ACA defines the term “exchange” to mean “an American Health Benefit exchange under section 1311 of ACA.”<sup>32</sup> When this definition is plugged into the text of Section 1321 of ACA, this provision compels the Secretary of HHS to establish an “American Health Benefit exchange established under [Section 1311 of the ACA] within the State.”<sup>33</sup> In other words, it is suggested that when HHS establishes an exchange, it is one that is “established under 1311,” and therefore, credits may be offered in the exchange. Additionally, Section 1321 of ACA provides that if a state does not establish an exchange, the federal government is required to “establish and operate *such* exchange within the State....”<sup>34</sup> The government argues that the word “such” demonstrates that the exchange the Secretary must establish *is* the one that the state declined to establish, conveying the idea that state and federally run exchanges are one and the same, and that when the federal government steps in to operate a state’s exchange on behalf of the state, “it does so standing in the state’s shoes.”<sup>35</sup> Explained another way, the government contends that the phrase “exchange established by the State under section 1311 of ACA” is, in essence, “a statutorily created term of art that includes federally-facilitated exchanges.”<sup>36</sup>

The government further argues that to limit premium tax credits to state-run exchanges is in stark contrast to the act’s goal of expanding access to affordable health insurance and maintaining stable insurance markets.<sup>37</sup> It is asserted that if premium tax credits were unavailable in federally facilitated exchanges, core provisions of ACA would not function properly.<sup>38</sup> In addition, it is claimed that millions of individuals would no longer be able to afford health insurance, and the loss of these consumers would have an extremely detrimental impact on the insurance markets in the affected states. This result, it is claimed, would defeat the main purpose of establishing exchanges and credits in the first place.<sup>39</sup> Also, according to the Administration, it is unreasonable to think that Congress would have designed a statutory scheme that would potentially jeopardize the effectiveness of the act and threaten insurance market security.<sup>40</sup>

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<sup>31</sup> See Brief of Appellees, *Halbig v. Burwell*, No. 14-5018 (D.C. Cir. October 3, 2014) (en banc) at 41. See also *id.* at 46 (“[P]laintiff’s interpretation is wrong for the more basic reason that it is not faithful to the statute’s text. Instead, it misreads that text in a manner that is divorced from statutory context and creates a statute at war with itself”).

<sup>32</sup> See *id.* at 16.

<sup>33</sup> See, e.g., *Halbig*, 759 F.3d at 399-400.

<sup>34</sup> Brief of Appellees, *Halbig v. Burwell*, No. 14-5018 (D.C. Cir. October 3, 2014) (en banc) at 22, quoting 42 U.S.C. §18041(c) (emphasis added).

<sup>35</sup> See, e.g., *Halbig*, 759 F.3d at 399-400 (“In other words, ‘such’ conveys what a federal exchange is: the equivalent of the exchange a state would have established had it elected to do so.”) See also Nicholas Bagley, *Three Words and the Future of the Affordable Care Act*, *Journal of Health Politics, Policy and Law*, available at <http://jhppl.dukejournals.org/content/early/2014/11/21/03616878-2867881.full.pdf+html>.

<sup>36</sup> Brief of Appellees, *Halbig v. Burwell*, No. 14-5018 (D.C. Cir. October 3, 2014) (en banc) at 16.

<sup>37</sup> Brief for Respondents in Opposition, *King v. Burwell*, No. 14-114 (U.S. October 3, 2014) at 11-12.

<sup>38</sup> See, e.g., *id.* at 24-27.

<sup>39</sup> See *id.* at 24.

<sup>40</sup> Brief for Respondents in Opposition, *King v. Burwell*, No. 14-114 (U.S. October 3, 2014) at 25-26. (“Petitioners’ reading transforms that “flexibility” into a threat: a State may forgo establishing an exchange for itself only at the price of crippling its insurance market and depriving its citizens of the tax credits at the heart of the Act ... There is no reason to believe that Congress wanted to confront States with such a threatening choice, or would have designed an alternative certain to fail.”).



## What lawsuits have been filed on this issue, and what is their current status?

As noted above, following issuance of the IRS regulations, at least four lawsuits were filed claiming the agency overstepped its authority when it interpreted the statute to allow premium tax credits to individuals participating in federally facilitated exchanges.

In *Halbig v. Burwell*, a group of individuals and employers residing in states that did not establish exchanges filed suit against the Departments of HHS and Treasury, claiming the IRS regulations violate the plain language of the ACA, which only permits credits to be available in “an exchange established by the State.”<sup>41</sup> In July 2014, the Court of Appeals for the D.C. Circuit reversed the district court, holding that ACA “unambiguously restricts” the availability of premium tax credits to health insurance purchased on state-established exchanges. Relying upon the judicial test articulated by the Supreme Court in *Chevron U.S.A., Inc. v. Natural Resources Defense Council*,<sup>42</sup> the appeals court examined whether Congress had spoken to the issue at hand and found that the statutory language of ACA clearly distinguishes between the creation of state and federally created exchanges for purposes of the credit.<sup>43</sup> The court also rejected the government’s contention that such construction of ACA would lead to illogical results under the act.<sup>44</sup> Finally, the court examined the legislative history accompanying ACA and concluded that there was nothing demonstrating that Congress intended a different result.<sup>45</sup> The *Halbig* opinion was later vacated pending review by the full appeals court of the D.C. Circuit, but the court subsequently placed a hold on the case pending the Supreme Court’s decision in *King*.

Conversely, in *King v. Burwell*,<sup>46</sup> the Court of Appeals for the Fourth Circuit upheld the IRS regulations as a valid exercise of agency discretion. In *King*, Virginia residents filed suit challenging the validity of the IRS rule, claiming that the IRS’s interpretation regarding the availability of premium tax credits is contrary to the statutory language of ACA.<sup>47</sup> On the same day that the D.C. Circuit issued its decision in *Halbig*, the Court of Appeals for the Fourth Circuit held that the relevant statutory language of ACA is ambiguous and subject to multiple interpretations.<sup>48</sup> Similar to *Halbig*, the court performed a *Chevron* analysis to determine whether the IRS’s actions were authorized by ACA. First, the Fourth Circuit examined ACA’s statutory language and found merit in both the plaintiff and defendant’s arguments.<sup>49</sup> But the court concluded that it could not conclusively determine what Congress intended with respect to this issue, and that “nothing in the legislative history of the Act provides compelling support for either side’s position.”<sup>50</sup> The appeals court then found the IRS interpretation to be a reasonable exercise of agency discretion, in concert with the overall goals of the ACA, and it deferred to the rule.<sup>51</sup>

<sup>41</sup> 758 F.3d 390 (D.C. Cir. 2014).

<sup>42</sup> 467 U.S. 837 (1984).

<sup>43</sup> *Id.* at 394.

<sup>44</sup> *Id.* at 402-04.

<sup>45</sup> *Id.* at 406-12.

<sup>46</sup> 759 F.3d 358 (4<sup>th</sup> Cir. 2014).

<sup>47</sup> The Commonwealth of Virginia declined to establish a state-run exchange.

<sup>48</sup> *King*, 759 F.3d at 363.

<sup>49</sup> *Id.* at 367-72.

<sup>50</sup> *Id.* at 372.

<sup>51</sup> *Id.* at 374-75. As the appeals court in *King* explained:

[I]t is ... clear that widely available tax credits are essential to fulfilling the Act’s primary goals and that Congress was aware of their importance when drafting the bill. The IRS Rule advances this  
(continued...)

The plaintiffs in *King* appealed their case directly to the Supreme Court. In November 2014, the High Court agreed to review the case.

In addition to *Halbig* and *King*, two other cases addressing this issue are currently pending. In *Oklahoma ex rel. Pruitt v. Burwell*,<sup>52</sup> a district court in Oklahoma concluded, similar to *Halbig*, that the plain text of ACA is clear that premium tax credits are only available in exchanges established by a state. It noted that “as [ACA] presently stands, ‘vague notions of a statute’s basic purpose are nonetheless inadequate to overcome the words of its text regarding the specific issue under consideration.’”<sup>53</sup> The district court ordered the IRS rule to be vacated, but stayed the decision pending an appeal. While the case is currently on hold at the Court of Appeals for the Tenth Circuit, the State of Oklahoma petitioned the Supreme Court to review its case together with *King*.<sup>54</sup> In January 2015, the Supreme Court denied Oklahoma’s petition.<sup>55</sup>

In a fourth case, *Indiana v. IRS*, the state of Indiana and 39 of the state’s school districts filed suit challenging the validity of the IRS regulations. The district court found that the state and the school districts had standing to challenge the IRS regulation, and it denied the Administration’s motion to dismiss the case.<sup>56</sup> The district court in *Indiana* later stayed the proceedings in this case, pending the Supreme Court’s decision in *King*.

### How did the plaintiffs have standing to sue?

In all of the court decisions thus far, the taxpayers were found to have standing to sue even though it is atypical for someone to have standing to challenge a tax credit on the grounds that the IRS took an overly permissible interpretation of the statute. The government has not raised the issue of standing before the Supreme Court in *King*. Standing is an integral part of the “case or controversy” requirement in Article III of the Constitution,<sup>57</sup> and it reflects the idea that the role of the judiciary is limited under the separation of powers principle upon which the government is founded.<sup>58</sup> The standing requirement is generally understood to require the plaintiff show a

(...continued)

understanding by ensuring that this essential component exists on a sufficiently large scale. The IRS Rule became all the more important once a significant number of states indicated their intent to forgo establishing exchanges. With only sixteen state-run exchanges currently in place, the economic framework supporting the Act would crumble if the credits were unavailable on federal exchanges. Furthermore, without an exception to the individual mandate, millions more Americans unable to purchase insurance without the credits would be forced to pay a penalty that Congress never envisioned imposing on them. The IRS Rule avoids both these unforeseen and undesirable consequences and thereby advances the true purpose and means of the Act. It is thus entirely sensible that the IRS would enact the regulations it did, making *Chevron* deference appropriate. Confronted with the Act’s ambiguity, the IRS crafted a rule ensuring the credits’ broad availability and furthering the goals of the law. In the face of this permissible construction, we must defer to the IRS Rule. *Id.*

<sup>52</sup> 2014 U.S. Dist. LEXIS 139501 (E.D. Okla. 2014).

<sup>53</sup> *Id.* at 25 (quoting *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 261 (1993)).

<sup>54</sup> Petition for a Writ of Certiorari Before Judgment, *State of Oklahoma ex rel. Pruitt v. Burwell*, No. 14-7080 (U.S. November 18, 2014).

<sup>55</sup> *Okl. ex rel. Pruitt v. Burwell*, 2014 U.S. Dist. LEXIS 139501 (E.D. Okla. 2014), *cert. denied*, 83 U.S.L.W. 3626 (Jan. 26, 2015)(No. 14-586).

<sup>56</sup> *Indiana v. IRS*, 2014 U.S. Dist. LEXIS 111068 (August 12, 2014).

<sup>57</sup> See U.S. CONST. Art. III, §2, cl. 1.

<sup>58</sup> See *Allen v. Wright*, 468 U.S. 737, 750 (1984).

“personal injury fairly traceable to the defendant’s allegedly unlawful conduct and likely to be redressed by the requested relief.”<sup>59</sup>

It is usually the case that a taxpayer who is eligible to receive a tax credit due to an IRS’s interpretation of a statute would not be injured since the government is interpreting the statutory language in a way that is favorable to the taxpayer. Furthermore, no one else would generally have standing either (e.g., taxpayers generally do not have standing solely because of their taxpayer status to challenge an expenditure of government funds).<sup>60</sup>

So, how did the taxpayers get standing to challenge the IRS regulation? Courts found standing based on the relationship between the premium tax credit and the individual and employer mandates. In *King* and *Halbig*, the courts determined that the plaintiffs faced an economic injury in that they would have to buy insurance or pay the individual mandate’s penalty since their eligibility for the premium tax credit under the IRS regulation meant they would not qualify for the mandate’s unaffordability exemption.<sup>61</sup> Similarly, the courts in *Pruitt* and *Indiana* found that the states had standing to challenge the regulation because, as employers, they would face compliance costs and other expenses due to the employer mandate.<sup>62</sup> These costs were attributable to the IRS regulation because the states would only be subject to the employer mandate if a state employee was allowed the premium tax credit, which, since the states had federally run exchanges, could only occur due to the IRS’ interpretation of the statute.

While the government did not raise the issue of standing before the Supreme Court in *King*, media reports have suggested that at least some *King* plaintiffs may not have standing—for example, because they may qualify for veterans benefits that would constitute minimum essential coverage for purposes of the individual mandate.<sup>63</sup> Justice Ginsburg inquired about the issue of their standing at the beginning of oral arguments, and the plaintiffs’ attorney asserted that at least one individual does meet the standing requirement.<sup>64</sup>

### **Why were the taxpayers not required to file a tax refund suit?**

In general, taxpayers who want to challenge the application of a federal tax law must do so through a tax refund suit.<sup>65</sup> This rule reflects a fundamental principle that tax laws can generally only be challenged after the taxes are paid, at which point the taxpayer may sue for a refund. As discussed above, the courts in these cases, however, generally found that the taxpayers were not required to go through the tax refund process in order to challenge the IRS’s Section 36B regulation.

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<sup>59</sup> *Id.* at 751.

<sup>60</sup> *See, e.g.*, *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 344-45 (2006) (reasoning that such taxpayers’ injuries are not particularized to those plaintiffs, but rather common to the general taxpaying public, and hypothetical because whether they will occur or be redressed depends on future actions by a legislative body).

<sup>61</sup> *See King*, 759 F.3d at 365-66; *Halbig*, 758 F.3d at 396-97.

<sup>62</sup> *See Pruitt*, 2013 U.S. Dist. LEXIS 113232 at \*29-30; *Indiana*, 2014 U.S. Dist. LEXIS 111068 at \*18-23.

<sup>63</sup> *See, e.g.*, Louise Radnofsky, *Questions Linger About Plaintiffs’ Legal Standing in Health-Law Case*, WALL ST. J. (March 4, 2015); Stephanie Mencimer, *The Supreme Court Is About to Hear the Case That Could Destroy Obamacare, Here are the unusual plaintiffs behind it*, MOTHER JONES (Feb. 9, 2015).

<sup>64</sup> Transcript of Oral Argument at 3-7, *King v. Burwell*, No. 14-114 (March 4, 2015) (Justice Ginsburg).

<sup>65</sup> *See* 26 U.S.C. §7421, 7422; 28 U.S.C. §§1346(a)(1), 2201(a).

First, the Anti-Injunction Act (AIA) generally prohibits courts from hearing suits for the purpose of restraining the assessment or collection of any tax.<sup>66</sup> If the AIA applied here, it would mean that the plaintiffs could only bring their cases as a tax refund suit. However, in the 2012 case *NFIB v. Sebelius*,<sup>67</sup> the Supreme Court, while upholding the individual mandate as a valid exercise of Congress’s taxing power, also held that the individual mandate is a penalty, not a tax, for AIA purposes and thus fell outside the act’s scope. Key to the Court’s analysis was that Congress had labeled the mandate as a “penalty” in the relevant statute and had not otherwise provided it should be treated as a tax for purposes of the AIA.<sup>68</sup> It appears that due to the Court’s decision in *NFIB*, the government did not raise the AIA issue in the premium tax credit litigation when the individual mandate provided the basis for the plaintiffs’ standing.<sup>69</sup> However, the government did argue that the AIA prevented the plaintiffs’ lawsuits when the employer mandate was the basis for standing. As such, three courts looked at this issue, and they reached different results. The *Pruitt* court, using the Court’s analysis in *NFIB*, found that the statute’s reference to the employer mandate as an “assessable payment” evidenced congressional intent for it not to be treated as a tax for AIA purposes.<sup>70</sup> The *Indiana* court determined the AIA did not apply due to binding precedent in the Seventh Circuit.<sup>71</sup> However, the district court in *Halbig* held that the employer mandate was a tax for purposes of the AIA and therefore dismissed the claims of the employers in the suit (the appellate court did not address this issue). The district court reasoned that Congress used the term “assessable payment” interchangeably with “tax” and intended them to have the same meaning.<sup>72</sup>

Distinct from the AIA issue but conceptually related, is the question of whether any of these plaintiffs were otherwise required to bring their challenges to the Section 36B regulation as a tax refund suit. Across the four cases, the government argued several different theories as to why other provisions of law required a tax refund suit. For example, the Administrative Procedure Act (APA) allows challenges to final agency actions “for which there is no other adequate remedy in a court,”<sup>73</sup> and the government argued that a tax refund suit was an adequate remedy since the taxpayer could receive any overpayment plus interest. The courts rejected these arguments for various reasons. For example, courts rejected the APA argument, reasoning that a tax refund suit was inadequate since it did not provide the same type of prospective relief as that provided under the APA.<sup>74</sup>

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<sup>66</sup> 26 U.S.C. §7421(a).

<sup>67</sup> 132 S. Ct. 2566 (2012). For more information, see CRS Report R42698, *NFIB v. Sebelius: Constitutionality of the Individual Mandate*, by (name redacted) and (name redacted).

<sup>68</sup> See *NFIB*, 132 S.Ct. at 2583.

<sup>69</sup> The fact these cases are challenging the premium tax credit, as opposed to the individual mandate, is arguably not relevant for AIA purposes since the Supreme Court has held that a credit does not involve the assessment or collection of tax for purposes of a federal law similar to the AIA. See *Hibbs v. Winn*, 542 U.S. 88, 101 (2004).

<sup>70</sup> *Oklahoma*, 2013 U.S. Dist. LEXIS 113232 at \*36.

<sup>71</sup> *Indiana*, 2014 U.S. Dist. LEXIS 111068 at \*24 (referencing *Korte v. Sebelius*, 735 F.3d 654 (7<sup>th</sup> Cir. 2013)).

<sup>72</sup> See *Halbig v. Sebelius*, 2014 U.S. Dist. LEXIS 4853, \*32-34 (D.D.C. January 15, 2014).

<sup>73</sup> 5 U.S.C. §704.

<sup>74</sup> See *King*, 759 F.3d at 366-67; *Halbig*, 758 F.3d at 397-98. See also *Indiana*, 2014 U.S. Dist. LEXIS 111068 at \*24 (characterizing IRS’ reading of the employer mandate statute as requiring a tax refund suit as “tortured”).

## Cases addressing the issue have relied on the *Chevron* test. What is that?

Under the APA, a party aggrieved by an agency's action may bring suit if he believes the agency has acted beyond its scope of authority.<sup>75</sup> A court would review such a challenge by employing the test established by the Supreme Court in *Chevron U.S.A., Inc. v. Natural Resources Defense Council*.<sup>76</sup>

The *Chevron* test proceeds in two parts to determine whether an agency has acted within its statutory authority. First, if Congress has spoken clearly on an issue, then the agency and the courts “must give effect to the unambiguously expressed intent of Congress.”<sup>77</sup> However, if the statute is ambiguous or silent, the court must determine whether the agency's construction of the statute is “permissible.”<sup>78</sup> The second part of the test is a deferential standard for judicial review. A reviewing court shall not determine whether the agency's construction is the most obvious or the best interpretation of the statute in question, but, instead, must yield to the agency's construction if it is merely a “permissible” reading of the statute.

The federal appellate courts—the Fourth Circuit and the D.C. Circuit (prior to the decision being vacated)—that evaluated the premium tax credit regulation both employed the *Chevron* test to determine whether tax credits were available in states that operate under a federal exchange.

## If the *King* and *Halbig* courts were both applying *Chevron*, how did they reach different results?

Because the second step of the test provides the agency with considerable deference, often cases involving a *Chevron* analysis will turn on whether a court determines the statutory text to be ambiguous. This is precisely what happened in the cases involving the premium tax credits. For example, in *Halbig*, the D.C. Circuit stated, “Because we conclude that the ACA *unambiguously* restricts the section 36B subsidy to insurance purchased on exchanges ‘established by the State,’ we ... vacate the IRS's regulation.”<sup>79</sup> Since the court found the text to be clear, the court did not have to proceed to step two, and the D.C. Circuit determined that the IRS regulation could not stand. As previously discussed, however, the D.C. Circuit vacated the *Halbig* decision pending an en banc review.

However, the Fourth Circuit, when reading the same provision of law, stated in *King*, “[W]e find that the applicable statutory language is *ambiguous* and subject to multiple interpretations. Applying deference to the IRS's determination, however, we uphold the rule as a permissible exercise of the agency's discretion.”<sup>80</sup> The Fourth Circuit, because it found the text to be ambiguous, proceeded to the highly deferential second step of the *Chevron* test and upheld the agency action.

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<sup>75</sup> 5 U.S.C. §§701, 702, 706.

<sup>76</sup> *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984); *see also* *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44 (2011) (“The principles underlying our decision in *Chevron* apply with full force in the tax context.”).

<sup>77</sup> *Chevron*, 467 U.S. at 842-43.

<sup>78</sup> *Id.*

<sup>79</sup> *Halbig*, 758 F.3d at 394.

<sup>80</sup> *King*, 759 F.3d at 363.

### ***How do courts determine whether a statutory provision is ambiguous?***

The Supreme Court, in a footnote, established that courts should use the “traditional tools of statutory construction” in order to ascertain whether “Congress had an intention on the precise question at issue.”<sup>81</sup> Courts often will use the structure of a statute to determine whether other sections of an act inform how the statutory provision in question should be evaluated. In addition, courts routinely use dictionaries to help ascertain the meaning of statutory language. The purpose of the legislation can also be helpful in determining whether Congress has spoken clearly on an issue.<sup>82</sup>

It is worth noting that the use of legislative history as a means of statutory interpretation has been a controversial subject.<sup>83</sup> The debate over the use of legislative history during *Chevron* step one stems from a much broader doctrinal debate between judges who believe legislative intent should be used to interpret statutes (commonly referred to as “intentionalist” judges) and judges who believe that the text of a statute is the only reliable means of determining a statute’s meaning (commonly referred to as “textualist” judges).

### ***Is it common for courts to disagree on whether a statute is ambiguous?***

Although the *Chevron* test has become a foundational principle of administrative law, judicial disagreement on whether a statute is ambiguous is not uncommon. Even the Justices of the Supreme Court often find themselves divided on whether Congress has spoken clearly on a specific issue. In numerous cases, including *Chemical Manufacturers Association v. Natural Resources Defense Council*<sup>84</sup> and *FDA v. Brown & Williamson Tobacco Corp.*,<sup>85</sup> the Supreme Court has split 5-4 on the issue of whether Congress has “directly spoken to the precise question at issue.”<sup>86</sup> Many issues at step one of the test appear to arise from a particular judge’s willingness to look beyond the plain text of the statute to the intent of Congress in order to determine whether the provision is ambiguous—that is, whether a judge is a “textualist” or an “intentionalist.” A textualist judge tends to believe that a stricter reading of the text should control when determining the meaning of a statute, while an intentionalist judge tends to be willing to look at the broader purpose of the statute and legislative intent when interpreting a law.

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<sup>81</sup> *Chevron*, 467 U.S. at 843 n. 9. According to the American Bar Association’s (ABA) black letter statement of administrative law: “Step one of *Chevron* does not dictate that courts use any particular method of statutory interpretation. However, the court should use “the traditional tools of statutory construction” to determine whether the meaning of the statute is clear with respect to the precise issue before it. For most judges, these tools include examination of the text of the statute, dictionary definitions, canons of construction, statutory structure, legislative purpose, and legislative history.” Section of Administrative Law & Regulatory Practice, American Bar Ass’n, *A Blackletter Statement of Federal Administrative Law*, 54 ADMIN L. REV. 1, 44 (2002).

<sup>82</sup> For a detailed review of statutory interpretation, see CRS Report 97-589, *Statutory Interpretation: General Principles and Recent Trends*, by (name redacted).

<sup>83</sup> For a discussion of the debate over the permissible tools of statutory interpretation in the *Chevron* test, see CRS Report R41260, *The Jurisprudence of Justice John Paul Stevens: The Chevron Doctrine*, by (name redacted).

<sup>84</sup> 470 U.S. 116 (1985).

<sup>85</sup> 529 U.S. 120 (2000).

<sup>86</sup> *Chevron*, 467 U.S. at 842-43.

## What can we expect from the Supreme Court in *King* regarding a *Chevron* analysis?

The Court may perform a *Chevron* analysis to determine whether IRS’s interpretation of the statute is permissible. As discussed above, it is not uncommon even for the Justices of the Supreme Court to disagree on whether a statute is clear or ambiguous. Ultimately, the outcome of the decision could largely depend on the Court’s analysis under step one of the *Chevron* test. In addition to determining whether the premium tax credits are available in states with a federal exchange, it is also possible that the Supreme Court’s decision could help clarify how the first step of the *Chevron* test should be applied.

## Could federalism considerations come into play in *King*?

At oral argument for *King*, some of the Justices addressed broader federalism considerations that might inform their statutory interpretation of the availability of premium tax credits. Justices Sotomayor and Kennedy, for instance, suggested that this case could be influenced by the canon of constitutional avoidance,<sup>87</sup> because the ACA might be read to raise federalism issues under the Tenth Amendment.<sup>88</sup> Under modern Tenth Amendment doctrine, Congress may not directly compel or “commandeer” state legislatures<sup>89</sup> or state executive branch officials<sup>90</sup> to implement federal programs, and in *South Dakota v. Dole*,<sup>91</sup> the Court held that indirect “coercion” of states by withdrawal of federal grant funds may also violate this amendment.

The suggestion has been made that, if premium tax credits were not available in states with federally facilitated exchanges, there might not be a viable marketplace for insurance companies in those states, and affordable insurance would not be available in the individual market. Thus, according to Justices Sotomayor and Kennedy, if the ACA were interpreted to make tax credits available to individuals enrolled in exchanges established by states, while denying such credits to individuals enrolled in federally facilitated exchanges, then states might be indirectly coerced to establish exchanges. If this reasoning holds, the canon of constitutional avoidance might counsel preferring a fair interpretation of the ACA that does not implicate possible Tenth Amendment problems.

The comments by Justices Sotomayor and Kennedy suggest a concern that states might be indirectly coerced to set up state exchanges by a threat of significant negative economic impact on individuals and businesses in those states. Neither party to the case, however, had raised the

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<sup>87</sup> CRS Report 97-589, *Statutory Interpretation: General Principles and Recent Trends*, by (name redacted) and generally CRS Report R43706, *The Doctrine of Constitutional Avoidance: A Legal Overview*, by (name redacted).

<sup>88</sup> Transcript of Oral Argument at 14-16, *King v. Burwell*, No. 14-114 (March 4, 2015) (Justice Sotomayor); *id.* at 16-18 (Justice Kennedy). Justice Sotomayor asked “In those States that don’t—their citizens don’t receive subsidies, we’re going to have the death spiral that this system was created to avoid. . . . Tell me how that is not coercive in an unconstitutional way?” *Id.* at 15. Justice Kennedy stated “Let me say that from the standpoint of the dynamics of Federalism, it does seem to me that there is something very powerful to the point that if your argument is accepted, the States are being told either create your own Exchange, or we’ll send your insurance market into a death spiral. We’ll have people pay mandated taxes which will not get any credit on—the subsidies. The cost of insurance will be sky-high, but this is not coercion. It seems to me that under your argument, perhaps you will prevail in the plain words of the statute, there’s a serious constitutional problem if we adopt your argument.” *Id.* at 16.

<sup>89</sup> *New York v. United States*, 505 U.S. 144 (1992).

<sup>90</sup> *Printz v. United States*, 521 U.S. 898 (1997).

<sup>91</sup> *South Dakota v. Dole*, 483 U.S. 203 (1987).

argument before the Court, and in response to a question from Justice Alito regarding this argument, Solicitor General Verrilli suggested that this was a “novel” constitutional issue.<sup>92</sup> Thus, the issue raised by the two Justices in *King* would appear to be whether a state can be constitutionally persuaded to exercise regulatory authority in order to avoid the application of a federal regulatory regime that could impose negative economic consequences on its individuals and businesses.<sup>93</sup>

The Supreme Court has previously considered situations where a state is given the opportunity to establish a regulatory program with the understanding that failure to do so will result in the federal government stepping in to regulate. This legislative regime has been called “cooperative federalism” by the Court and is used in many different regulatory areas, especially environmental law.<sup>94</sup> It does not appear that the Supreme Court has suggested that placing new burdens on individuals and businesses under federal regulation effectively coerces states to act in violation of the Tenth Amendment.

For instance, in *New York v. United States*, the Court considered a regime where states may either regulate the disposal of radioactive waste according to federal standards by attaining local or regional self-sufficiency, or their residents who produce radioactive waste would be subject to federal regulation authorizing states and regions to deny access to their disposal sites.<sup>95</sup> The Court rejected a Tenth Amendment challenge to this regime, noting that “affected States are not compelled by Congress to regulate, because any burden caused by a State’s refusal to regulate will fall on those who generate waste and find no outlet for its disposal, rather than on the State as a sovereign.”<sup>96</sup>

As in *New York*, the *King* case involves provision to states of the opportunity to establish their own regulatory regime in order to avoid the establishment of a federal regulatory regime. It is unclear, however, how the Court might apply the reasoning of *New York* to the *King* case. The implication of *New York* is that burdens that fall on individuals and businesses are not considered as part of a coercion analysis, yet Justices Sotomayor and Kennedy’s questions could potentially suggest that such a burden might be important. It may be arguable that the purposes and structure of the ACA are sufficiently different from the statute at issue in *New York*, and the regime of cooperative federalism sufficiently distinct, for the Court to adopt a different look at whether adverse economic effects on private entities might raise Tenth Amendment issues in the context of ACA.

Additional federalism concerns were discussed at oral argument when Justice Alito considered the government’s argument that, under cases such as *Pennhurst State School & Hospital v.*

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<sup>92</sup> Transcript of Oral Argument at 49, *King v. Burwell* (Solicitor General Verrilli).

<sup>93</sup> *New York v. United States*, 505 U.S. at 166-69 (1992). “Our cases have identified a variety of methods, short of outright coercion, by which Congress may urge a State to adopt a legislative program consistent with federal interests. Two of these methods are of particular relevance here. First, under Congress’ spending power, ‘Congress may attach conditions on the receipt of federal funds.’ *South Dakota v. Dole*, 483 U.S. at 206. . . . Second, where Congress has the authority to regulate private activity under the Commerce Clause, we have recognized Congress’ power to offer States the choice of regulating that activity according to federal standards or having state law pre-empted by federal regulation.”

<sup>94</sup> *New York* at 167-68.

<sup>95</sup> *Id.* at 174.

<sup>96</sup> *Id.*



*Halderman*,<sup>97</sup> Congress must give clear notice of its intentions before imposing potentially onerous conditions on states. Justice Alito offered that if the Court found that premium tax credits were not available to taxpayers in federally facilitated exchanges, states might choose to establish their own exchanges, thus reducing the potential for economic harm.<sup>98</sup> Further, Justice Alito suggested that the Court could delay the implementation of the plaintiffs' interpretation till the end of the tax year, again reducing potentially disruptive economic consequences.<sup>99</sup> Finally, Justice Scalia proposed that Congress might also act to avoid any serious consequences to states arising from the Court's decision.<sup>100</sup>

Although there are other statutory considerations that may ultimately be more important to the resolution of the *King* case, the discussion by some of the Justices at oral argument potentially suggests that federalism may play a role in the resolution of this statutory interpretation case.

### III. Potential Implications of the Court's Decision in *King*

#### How many exchanges are considered to be run by the federal government and could be affected by the Supreme Court's decision?

Assuming the Supreme Court finds that premium tax credits are unavailable in exchanges that are not established by a state, the question of which exchanges fall into this category may be considered. In 2015, there are 27 states in which exchanges are established and run entirely by the federal government.<sup>101</sup> Seven more states maintain "partnership exchanges," which HHS considers to be federally facilitated.<sup>102</sup> While HHS maintains authority over these partnership exchanges, a state can administer and operate certain exchange activities. There are also three states that have "federally supported state-based exchanges." It appears these three states received (at least conditional) approval from HHS<sup>103</sup> to run their own exchange and perform all exchange functions, but the states rely on the federally facilitated exchange IT platform (i.e., <http://www.healthcare.gov>).<sup>104</sup>

In 2014, there appeared to be some disagreement over how many exchanges were run by the federal government. While the D.C. Circuit in *Halbig* indicated in dicta that there were 36 federal

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<sup>97</sup> 451 U.S. 1 (1981).

<sup>98</sup> Transcript of Oral Argument at 52, *King v. Burwell* (Justice Alito).

<sup>99</sup> *Id.* at 53. See Legal Sidebar WSLG1191, *King v. Burwell*: Can the Supreme Court delay the implementation of the upcoming ACA ruling?, by (name redacted) and (name redacted).

<sup>100</sup> Transcript of Oral Argument at 54 (Justice Scalia).

<sup>101</sup> See Kaiser Family Foundation, State Health Insurance Marketplace Types, 2015, available at <http://kff.org/health-reform/state-indicator/state-health-insurance-marketplace-types/>.

<sup>102</sup> See Department of Health and Human Services, The Center for Consumer Information & Insurance Oversight, State Health Insurance Marketplaces, available at <http://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/state-marketplaces.html>.

<sup>103</sup> See Centers for Medicare and Medicaid Services, Center for Consumer Information & Insurance Oversight, State Health Insurance Marketplaces, available at <http://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/state-marketplaces.html>.

<sup>104</sup> See, e.g., Department of Health and Human Services, FY 2016, Centers for Medicare and Medicaid Services, Justification of Estimates for Appropriations Committees at 64 ("CMS also performs eligibility and enrollment functions on behalf of State-Based Marketplaces (Oregon, Nevada and New Mexico specifically) on the FFM platform.").

exchanges, the Fourth Circuit in *King* noted there were 34.<sup>105</sup> Presumably, the discrepancy is based on the two federally supported state-based exchanges operating last year. Nevertheless, it may be noted that the Supreme Court briefs filed by both petitioners and respondents in the *King* case seem to agree that there are 34 federally facilitated exchanges.<sup>106</sup> This number would appear to include the 27 federally facilitated exchanges and the 7 state-partnership exchanges, and exclude states with a federally supported state-based exchange. The Supreme Court could address what states must do in order to “establish an exchange” for purposes of the premium tax credits under ACA. Alternatively, the Court may render a decision without answering this question, and regulations issued by IRS and HHS could potentially address this issue.

### **If the Supreme Court upholds the IRS regulations at issue in *King*, what happens?**

If the Supreme Court finds that the IRS regulations at issue in *King* are valid, it may be presumed that the agency would not need to amend the regulations or take any other action, and that premium tax credits would remain available for individuals participating in state and federally run exchanges in every state and the District of Columbia. However, such a holding may not preclude the IRS from amending the regulations at a future date. Assuming that the Court performs a *Chevron* analysis and finds that the statutory language of ACA is ambiguous and subject to multiple interpretations,<sup>107</sup> the agency would remain free to amend the regulations, so long as the amendments are consistent with the statute.<sup>108</sup> Thus, it is possible that if the Supreme Court in *King* decides to defer to the IRS’s interpretation of ACA, an administration could potentially later amend the regulations in a manner that affects the provision of premium tax credits in federal and state-run exchanges. The Court’s opinion in the *King* case may address this scenario.

### **If the Supreme Court finds that premium tax credits are unavailable in *King*, what happens?**

If the Supreme Court finds that the IRS regulation at issue in *King* is invalid so that individuals participating in federally run exchanges would no longer be eligible for the credit, then several things might happen. The IRS would presumably act to address the problematic aspects of the Section 36B regulations. Additionally, the agency (and HHS) might determine that additional rulemaking or guidance is appropriate to address possible issues arising from the interaction between the premium tax credit and other parts of the IRC and ACA (discussed in the next question).

The IRS, affected taxpayers, and insurance companies might also confront issues due to the timing of the Court’s decision. It is likely the decision will be released late in the Court’s term, after April 15, 2015, but before the end of June. By that time, taxpayers claiming the credit for tax year 2014 will have generally done so. Additionally, some taxpayers will be receiving the credit for tax year 2015 in the form of advanced payments made directly to their insurance

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<sup>105</sup> *Halbig*, 758 F.3d at 395. *Cf. King*, 759 F.3d at 364.

<sup>106</sup> Brief for Petitioner at 7, *King v. Burwell*, No. 14-114 (U.S. July 31, 2014); Brief for Respondents in Opposition at 8, *King v. Burwell*, No. 14-114 (U.S. Oct. 3, 2014).

<sup>107</sup> See footnotes 79-86 *supra* and accompanying text.

<sup>108</sup> *Committee for Effective Cellular Rules v. Fed. Communications Comm’n*, 53 F.3d 1309, 1317 (D.C. Cir. 1995).

companies.<sup>109</sup> Thus, in addition to raising questions about whether taxpayers who received the credit would be required to pay it back (see below), it seems possible the timing of the Court's decision might present issues with respect to the advanced payments being made for 2015 insurance contracts. During the *King* oral arguments, Justice Alito raised the issue of whether the Court could stay its decision until the end of the year.<sup>110</sup>

One point to note is that while the Court's decision may result in some taxpayers losing their eligibility for the premium tax credit, it would not impact their ability to claim other tax benefits. Thus, for example, affected taxpayers who purchased insurance would be able to deduct their premiums as an itemized deduction to the extent their total medical expenses exceed 10% of adjusted gross income.<sup>111</sup>

### **If the Court strikes down the IRS regulations at issue in *King*, what are some of the ways in which the operation of ACA could be affected?**

If premium tax credits cannot be offered in health insurance exchanges run by the federal government, many believe there could be a profound effect upon the operation and implementation of ACA as a whole because certain central provisions of the act depend upon the availability of premium tax credits.<sup>112</sup>

As noted above, ACA contains certain interconnected provisions that are designed to increase accessibility to health insurance.<sup>113</sup> Among these provisions, ACA contains certain market reforms that, among other things, require health insurers to accept every individual who applies for coverage, prevent them from imposing exclusions from coverage based on preexisting conditions, and restrict insurers from charging higher premiums based on an individual's health status.<sup>114</sup> Based on these requirements, it is argued that in order to prevent an "adverse selection" scenario, where individuals wait to purchase health insurance until they need care, ACA compels individuals to purchase insurance through the individual mandate.<sup>115</sup> In order to make this

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<sup>109</sup> Some affected taxpayers might find themselves in the position of having bought insurance with the expectation they would be receiving a credit for which they are suddenly no longer eligible. They may argue this is unfair, particularly since they relied on an unambiguous IRS regulation. From a legal perspective, the fact taxpayers may have concluded a transaction in reliance on prior tax law is generally not important and would not support a claim against the government (e.g., for violation of due process or breach of contract). *See, e.g.,* *United States v. Carlton*, 512 U.S. 26, 34 (1994) (no due process violation from retroactive change in tax law); *Nat'l R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 465-66 (1985) (statutes do not create a contractual arrangement absent clear evidence of congressional intent to do so).

<sup>110</sup> Transcript of Oral Argument at 53, *King v. Burwell*, No. 14-114 (March 4, 2015) (Justice Alito). For analysis of the Court's ability to stay its decision, see CRS Legal Sidebar WSLG1191, *King v. Burwell: Can the Supreme Court delay the implementation of the upcoming ACA ruling?*, by (name redacted) and (name redacted).

<sup>111</sup> 26 U.S.C. §213 (threshold is reduced to 7.5% for taxpayers who are at least 65 years old). These taxpayers would no longer be limited by the provision that prohibits a deduction for the portion of the premiums that is equal to the amount of the premium tax credit. 26 U.S.C. §260C(g).

<sup>112</sup> *See generally* David Blumenthal and Sara R. Collins, *The Supreme Court Decides to Hear King v. Burwell: What Are the Implications?* The Commonwealth Fund Blog, (November 7, 2014), available at <http://www.commonwealthfund.org/publications/blog/2014/nov/the-supreme-court-decides-to-hear-king>. *See also King*, 759 F.3d at 374, ("As the defendants ... explain, denying tax credits to individuals shopping on federal Exchanges would throw a debilitating wrench into the Act's internal economic machinery ...").

<sup>113</sup> Brief for Respondents in Opposition, *King v. Burwell*, No. 14-114 (U.S. October 3, 2014) at 3.

<sup>114</sup> P.L. 111-148, §1201 (codified at 42 U.S.C. §300gg-1; 42 U.S.C. §300gg-3; 42 U.S.C. §300gg-4).

<sup>115</sup> *See, e.g., Halbig*, 758 F.3d at 409.

required coverage affordable, ACA provides for premium tax credits and other subsidies.<sup>116</sup> It has been argued that eliminating premium tax credits would be detrimental to this scheme, as these provisions “work in tandem to achieve the Act’s fundamental goals of expanding health-insurance coverage and promoting a functioning individual insurance market in each State.”<sup>117</sup>

Relatedly, it is also expected that if premium tax credits are unavailable to individuals enrolled in a federally run exchange, fewer individuals will be required to have health insurance under ACA’s individual mandate. As discussed in the “I. Background” section, there is an exemption from the individual mandate for individuals whose contribution to health coverage is more than 8% of household income.<sup>118</sup> ACA specifies that this contribution is calculated for certain individuals as the annual premium for the lowest cost plan available on an exchange in the state, *minus any allowable premium tax credit*.<sup>119</sup> Accordingly, if an individual is not allowed the premium credit, coverage becomes more expensive, and the unaffordability exemption may kick in, meaning that the individual does not have to obtain coverage under the individual mandate. It has been predicted that eliminating the premium tax credits in states with federally run exchanges would exempt more individuals from the individual mandate, and would make coverage unaffordable for many of these individuals.<sup>120</sup>

Commentators have also noted that if the Supreme Court invalidates the IRS rule, this could have a debilitating effect on the federally run exchanges.<sup>121</sup> The idea is that absent these credits, many healthy people would not purchase health coverage.<sup>122</sup> However, individuals with more serious health conditions would probably remain in the market. Thus, it is argued that the population in these plans could become skewed toward sicker, more expensive enrollees, and this may lead to a rise in premiums in affected exchanges.<sup>123</sup>

The absence of premium tax credits in states with a federally facilitated exchange could also affect the application of the employer mandate.<sup>124</sup> As discussed in the “I. Background” section, ACA specifies that liability for the excise tax under the employer mandate is generally triggered when one or more of an employer’s full-time employees is allowed a premium tax credit through a health insurance exchange.<sup>125</sup> Accordingly, if credits are not available in states with federally

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<sup>116</sup> See, e.g., *id.*

<sup>117</sup> Brief for Respondents in Opposition, *King v. Burwell*, No. 14-114 (U.S. October 3, 2014) at 6.

<sup>118</sup> 26 U.S.C. §5000A(e)(1).

<sup>119</sup> 26 U.S.C. §5000A(e)(1)(B)(ii) (emphasis added).

<sup>120</sup> See Linda J. Blumberg, John Holahan, and Matthew Buettgens, *Halbig v Burwell: Potential Implications for ACA Coverage and Subsidies*, Robert Wood Johnson Foundation, Urban Institute, (July 2014), available at <http://www.urban.org/UploadedPDF/413183-Halbig-v-Burwell-Potential-Implications-for-ACA-Coverage-and-Subsidies.pdf>.

<sup>121</sup> See, e.g., Nicholas Bagley, *Three Words and the Future of the Affordable Care Act*, *Journal of Health Politics, Policy and Law*, available at <http://jhpl.dukejournals.org/content/early/2014/11/21/03616878-2867881.full.pdf+html>.

<sup>122</sup> *Id.*

<sup>123</sup> *Id.* Additionally, as the dissenting Justices of the Supreme Court noted in *NFIB v. Sebelius* “[w]ithout the federal subsidies, individuals would lose the main incentive to purchase insurance inside the exchanges, and some insurers may be unwilling to offer insurance inside of exchanges. With fewer buyers and even fewer sellers, the exchanges would not operate as Congress intended and may not operate at all.” 132 S. Ct. 2566, 2674 (2012) (Scalia, Kennedy, Thomas, and Alito, JJ., dissenting). For more information on the *NFIB* case, see CRS Report R42698, *NFIB v. Sebelius: Constitutionality of the Individual Mandate*, by (name redacted) and (name redacted).

<sup>124</sup> Implementation of the employer mandate is being phased in. See discussion *supra* note 21.

<sup>125</sup> 26 U.S.C. §4980H(b).

run exchanges, large employers may not be subject to penalties if they fail to offer affordable coverage to employees.<sup>126</sup>

### **If the Supreme Court in *King* finds that premium tax credits cannot be offered in federally facilitated exchanges, what does a state have to do to “establish an exchange” and continue offering premium tax credits?**

If the Court finds that premium tax credits are not available in federally run exchanges, the question arises what states would have to do to in order for their exchange to be “established by the state under section 1311” for purposes of the credit.

Current law and regulations articulate what steps a state must take in order for the federal government not to set up an exchange within the state. Section 1311 of ACA specifies that a state “shall” establish an exchange that meets certain specified requirements.<sup>127</sup> This section provides that an exchange must be “a governmental agency or nonprofit entity that is established by a State.”<sup>128</sup> Additionally, under this section, among other things, an exchange must implement procedures related to the certification of health plans; provide for the operation of a telephone hotline; maintain a website under which current and prospective plan enrollees may obtain plan information; assign ratings to qualified health plans in the exchange, in accordance with criteria developed by the Secretary of HHS; use a standard format for presenting health benefit plan options in the exchange; and inform individuals of their eligibility for public programs such as Medicaid and assist with this enrollment.<sup>129</sup> Current regulations also set forth numerous requirements that a state must meet in order for its exchange to be approved by HHS.<sup>130</sup> As described above, if a state does not have this approval (or conditional approval) by a certain deadline, HHS will establish and operate the state’s exchange.<sup>131</sup>

While the circumstances under which the federal government will assist with establishing an exchange within the state are thus well described in current law and regulations, the question of what it means to have “an exchange established by the state under 1311” could arguably be somewhat different than whether the federal government has chosen to assist with establishing an exchange within the state. Questions have been raised, for example, regarding whether states could qualify as having state-established exchanges while retaining a certain degree of federal marketplace infrastructure (e.g., certain state-based exchanges utilize [healthcare.gov](http://healthcare.gov)).<sup>132</sup> The Supreme Court may address what states must do in order to “establish an exchange” so that premium credits are available. Alternatively, the Court may render a decision without answering

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<sup>126</sup> However, an employer may still potentially be subject to tax if the employer has a place of business in a state with a federal exchange, but employs individuals who reside in a different state that has a state-run exchange.

<sup>127</sup> 42 U.S.C. §18021. *See also Halbig*, 758 F.3d at 399 (“[D]espite its seemingly mandatory language, §1311 of the Act more cajoles than commands. A state is not literally required to establish an Exchange; the ACA merely encourages it to do so.”).

<sup>128</sup> 42 U.S.C. §18021(b).

<sup>129</sup> 42 U.S.C. §18021.

<sup>130</sup> 42 C.F.R. §155.10 et seq. These regulations specify, for example, that a state must submit an “exchange blueprint” that specifies how the state’s exchange meets the requirements set out in the regulations, and the state must demonstrate readiness to execute this blueprint. 45 C.F.R. §155.105.

<sup>131</sup> 45 C.F.R. §155.105(f).

<sup>132</sup> *See generally* Blumenthal and Collins, note 112 *supra*.

this question. In that case, the answer may ultimately require administrative action by IRS and HHS, or further litigation to be resolved.

### **If the Supreme Court rules in favor of the challengers, would taxpayers enrolled in plans in federal exchanges be forced to pay back any credits they have claimed?**

As mentioned, taxpayers are allowed to claim the credit when they file their taxes at the end of the year or may choose to receive an estimated credit paid in advance to their insurance company. For both sets of taxpayers, it is not clear that any who claimed the credit might be required to pay it back if the Court were to strike down the regulation.<sup>133</sup> On the one hand, as a general rule, taxpayers who improperly claim tax credits must pay them back and, in the case of taxpayers receiving an estimated premium tax credit in advance, pay back any excess. Further, the IRS is generally able to go back to the previous three tax years in order to reclaim erroneously paid refunds, even when the agency was at fault for the overpayment.<sup>134</sup> And in some situations, courts have recognized that the IRS occasionally gets the law wrong and it is the taxpayer's responsibility to get it right.<sup>135</sup> As such, if the Court were to strike the regulation so that taxpayers who purchased insurance in federally facilitated exchanges were not allowed the credit, it might be argued that taxpayers could be required to pay back any claimed credit to the IRS.

On the other hand, these taxpayers claimed the credit due to their reliance on an unambiguous IRS-promulgated regulation. As such, it is arguably unfair to require them to pay back any claimed credit, perhaps particularly so if they were not party to the litigation resulting in their denial of the credit. Further, the situations where courts have not reacted sympathetically to taxpayers who relied on erroneous IRS information can be distinguished since those taxpayers were relying on guidance less formal than a regulation. In light of all this, even if there might be a legal basis for concluding that taxpayers might have to pay back the credit, it seems possible the Court, Congress, or IRS would take mitigating actions. For example, if the Court were to strike down the regulation, the Court could conceivably limit its holding so that taxpayers who had received the credit (whether through the advance payment or end-of-year filing) would not be affected. Similarly, the IRS might have the authority to provide that taxpayers who had already claimed the credit would not have to pay it back or to take no action to assess and collect the amounts from them.<sup>136</sup> It is also possible that Congress could address the issue by legislation. CRS is not aware of any example of where a court struck a credit or other tax benefit and the taxpayers who had already received the benefit were required to pay it back;<sup>137</sup> however, it should

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<sup>133</sup> In no case does it appear that the insurance company who received the advanced payment would be responsible for paying back the credit since that company merely accepted the credit as payment from the taxpayer for the premiums.

<sup>134</sup> 26 U.S.C. §6229. See also *O'Bryant v. United States*, 49 F.3d 340 (7<sup>th</sup> Cir. 1995).

<sup>135</sup> See, e.g., *Carpenter v. United States*, 495 F.2d 175, 184 (5<sup>th</sup> Cir. 1975) (dismissing the fact that the taxpayer had relied on an inaccurate statement of law found in an IRS publication since "it is for the Congress and the courts and not the Treasury to declare the law applicable to a given situation"); *Miller v. Comm'r*, 114 T.C. 184, 195 (2000) ("Well-established precedent confirms that taxpayers rely on such [IRS] publications at their peril. Administrative guidance contained in IRS publications is not binding on the Government, nor can it change the plain meaning of tax statutes.").

<sup>136</sup> See 26 U.S.C. §§36B(g), 7805(a)&(b).

<sup>137</sup> See, e.g., California Franchise Tax Board, *Qualified Small Business Stock (QSBS) Gains – FAQs, October 7, 2013 update on QSBS gains, available at [https://www.ftb.ca.gov/law/Qualified\\_Small\\_Business\\_Stock\\_and\\_Cutler\\_Decision.shtml](https://www.ftb.ca.gov/law/Qualified_Small_Business_Stock_and_Cutler_Decision.shtml)* (after a state tax benefit was struck down as violating the dormant Commerce Clause, the state tax agency had initially indicated that taxpayers would have to pay back amounts received during the prior four open tax years plus interest, but the state legislature subsequently amended the law so (continued...))

be noted that this issue rarely arises because, as discussed above, no one typically has standing to bring this type of suit.

### Could a ruling in the *King* case have consequences for other tax laws or credits?

A consideration in assessing whether *King* may have implications for tax law generally is recognizing that the situation presented is uncommon. The plaintiffs are challenging an IRS regulation that interprets a statute so that they are eligible for a credit. Normally, a taxpayer would not want to sue arguing the IRS had impermissibly broadened a statute to benefit them, and in any case, would not have standing to do so. Here, the plaintiffs' concerns and standing are based on the interaction between the premium tax credit and the individual mandate. This type of interaction between a tax benefit and obligation is rare. Thus, due to the atypical facts present here, it is not clear whether *King*, regardless of how the Court rules, will have broad implications for impact tax law generally.

*King* and the other cases nonetheless might provide two procedural issues in which Congress might be interested—the applicability of the AIA and the relationship between the APA and tax refund suits (note that neither issue has been appealed to the Court). This is not to suggest that the lower courts necessarily got these issues wrong. Rather, these cases might be of interest because, as discussed above, it is generally the rule that taxpayers challenging a federal tax law must do so through a tax refund suit, and while the government argued these taxpayers needed to do the same, the courts rejected this. Regardless of which side it agrees with, Congress might be interested in looking at these decisions to see if statutory clarification is needed. First, as discussed above, the AIA generally prohibits suits that restrain the collection and assessment of federal taxes. While the Supreme Court in *NFIB* found that the individual mandate was not a tax for purposes of the AIA because Congress labeled it as a penalty, Congress's motivation in using the term "penalty" appears open to debate. In light of the Court's holding and its application to the cases here, as well as potential extension to other excise taxes,<sup>138</sup> it might be of interest to Congress to look at these cases to ensure their reasoning is consistent with the congressional intent behind the AIA and, if so, how other excise taxes might be affected.<sup>139</sup> Similarly, the issue of whether a tax refund suit is an "adequate remedy" under the APA does not frequently arise, and it might be of interest to Congress to look at how the courts in these cases interpreted the interaction between the two acts.

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(...continued)

that taxpayers were not required to pay back the benefits); Minn. Laws 1974, ch. 556, §20 (after a state tax credit was struck down as violating the First Amendment, a law was passed prohibiting the state tax commissioner from "requir[ing] reimbursement or restitution of any such credits or refunds previously granted, where such recipients were legally entitled thereto under laws in effect at the time such claim was filed by the applicant, or to seek recovery of any amounts by legal action").

<sup>138</sup> See, e.g., *Korte v. Sebelius*, 735 F.3d 654 (7<sup>th</sup> Cir. 2013) (finding that the excise tax in Section 4980D on the failure to meet certain group health plan requirements was a penalty for purposes of the AIA, reasoning that, while Congress clearly labeled it as a tax, it functions as a penalty).

<sup>139</sup> In March 2015, the Supreme Court released another decision that might have consequences for the AIA. In *Direct Marketing Association v. Brohl*, 135 S. Ct. 1124 (2015), the Court took an arguably narrow interpretation of the Tax Injunction Act (TIA), which limits the ability of federal courts to hear cases restraining the collection of state taxes. Due to the similar language and purpose of the AIA and TIA, it has been suggested that *Brohl* could lead courts to interpret the AIA in a similar narrow fashion and thus further limit the act's applicability. See, e.g., Marie Sapirie, *The Effect of Direct Marketing Association*, STATE TAX TODAY, 2015 STT 60-1 (March 24, 2015).

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