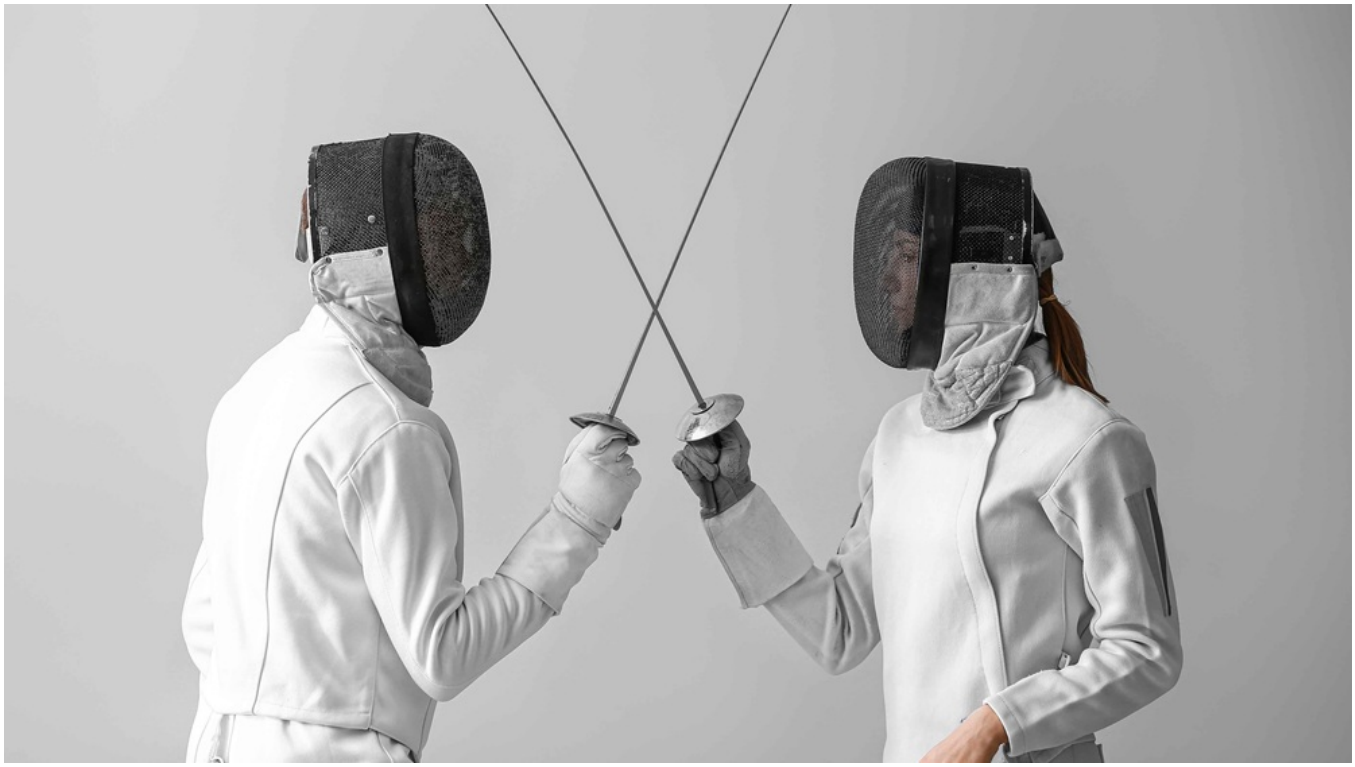
JULY 24, 2014

Dueling Court Cases Issued on Same Day



On Tuesday morning the U.S. Court of Appeals for the District of Columbia Circuit ruled that an IRS rule for a key piece of the 2010 Affordable Care Act is invalid. The ruling invalidates tax credits/subsidies for low income individuals who purchase health insurance coverage on the federally-run exchange (but does not affect credits for those purchasing coverage under a state-run exchange). Later that day, the U.S. Court of Appeals for the Fourth Circuit came to a contrary decision, upholding the IRS rule and, with it, the credits for individuals who purchase coverage through a federally-run exchange.

The Background

As background to these two similar cases, the Affordable Care Act provides in Section 36B of the Tax Code that tax credits (often referred to as subsidies) are available to certain low income individuals to purchase coverage through an exchange "established by the State." On its face, the statute authorizes tax credits for insurance purchased on an exchange established by one of the fifty states or the District of Columbia. At the time of the ACA's passage, the Administration thought that most states would establish their own state exchange. However, as it turned out, only approximately 1/3 of the states established their own exchange, leaving 2/3 of the states to be included in the federal exchange.

"Because of questions raised by the wording of Section 36B, the Internal Revenue Service issued a rule interpreting the above statute broadly and determining that that tax credits are available to eligible individuals who purchase coverage through both a state or federal exchange"

Because of questions raised by the wording of Section 36B, the Internal Revenue Service issued a rule interpreting the above statute broadly and determining that that tax credits are available to eligible individuals who purchase coverage through both a state or federal exchange. This was an important ruling because, without these tax credits, many other pieces of the Affordable Care Act do not work: employer penalties are triggered by the subsidies, individual penalties depend on coverage being affordable which in turn may depend on the subsidies, and the current pricing of insurance policies assume a certain level of broad-based participation

which is not sustainable without the subsidies.

In the D.C. case, *Halbig v. Burwell*, No. 14-5018 (D.C. Cir. July 22, 2014), four individuals and three employers argued that the ACA only allowed tax credits for insurance purchased through a state exchange, not the federal exchange, and that the IRS exceeded its regulatory authority in issuing a different interpretation. A three-judge panel of the US Court of Appeals sided with the challengers based on the plain reading of the statute which refers to exchanges "established by a State". You can read the case here.

In the Fourth Circuit case, *King v. Burwell*, No. 14-1158 (4th Cir. July 22, 2014), Virginia residents who did not want to purchase health coverage also challenged the authority of the IRS to issue this rule which, they believe, contradicts the statute. Without the tax credit, they would not be subject to the individual mandate because the policies would be unaffordable. A three-judge panel ruled against the plaintiffs and upheld the IRS rule, after concluding that the same statute and legislative history were ambiguous, which then required that the court to defer to the IRS's determination, as long as the IRS rule was based on a permissible construction of the statute. You can read the case here.

What This Means

The Administration is expected to request a review of the decision by the full D.C. Circuit Court; the plaintiffs in the Fourth Circuit case are not expected to make a similar request because they would likely prefer to appeal their decision to the US Supreme Court. It's unclear how the Supreme Court would rule, but as pointed out in the D.C. ruling, it may be hard for them to get past the plain reading of the statute, even though without this reading, the rest of the law will be difficult, if not impossible, to implement. But, as the prior Supreme Court case has shown, the court has an uncanny ability to issue opinions, while remaining apolitical. A legislative change is also possible, but highly unlikely if the current make-up of Congress remains the same after the November elections.

It will take many months to sort this out, but in the meantime, tax credits will continue for those buying coverage on the federal exchanges, and employers and insurers will need to continue their compliance efforts for 2015.