
Contradictory Court Rulings on Tax Credits for PPACA Federal Exchanges

By Kristi R. Gauthier / Jul 23, 2014

On July 22, 2014, the U.S. Court of Appeals for the District of Columbia Circuit ruled 2-1 that the federal government may not provide tax credits to individuals that purchase their health insurance coverage through federally-facilitated exchanges established pursuant to the Patient Protection and Affordable Care Act ("PPACA"). *Halbig v. Burwell*, D.C. Cir., No. 14-5018 (D.C. Cir. July 22, 2014). A few hours later, the U.S. Court of Appeals for the Fourth Circuit upheld the federal government's authority to provide tax credits to those who purchase their coverage through federally-facilitated exchanges. *King v. Burwell*, 4th Cir., No. 14-1158 (4th Cir. July 22, 2014).

Currently only 14 states and the District of Columbia have set up state-based exchanges. All other states have a federally-facilitated exchange with a few exchanges implemented as partnerships with states. PPACA enacted Section 36B of the Internal Revenue Code which provides tax credits as a form of subsidy to qualified individuals who purchase health insurance through exchanges that are "established by the State under Section 1311." The IRS, through its rulemaking, interpreted Section 36B as providing the IRS the ability to also offer tax credits to individuals who purchase insurance on federally-facilitated exchanges. The plaintiffs in both cases challenged this interpretation.

The plaintiffs in *Halbig* and *King* generally argued that the availability of tax credits increased the number of people who must purchase health insurance or pay a penalty. With tax credits available, the federally-facilitated exchange health plans would be provided at a reduced cost and, therefore, these plaintiffs would not qualify for the unaffordability exemption from the individual mandate penalty. In addition, the plaintiffs in *Halbig* argued that offering tax credits would expose large employers to penalties for failing to offer coverage to their full-time employees under the employer-mandate provisions. An "applicable large employer" will face penalties if one of its full-time employees purchases health insurance on a federally-facilitated exchange and receives or is able to receive an applicable tax credit.

The D.C. Circuit analyzed whether an exchange established by the federal government is an "exchange established by the State under Section 1311" of PPACA. The appellate court found that there was no textual basis provided by PPACA sections regarding exchanges or elsewhere in PPACA that could lead the court to determine a federally-facilitated exchange is, in fact or legal fiction, established by a state. Therefore, the appellate court held that Section 36B did not authorize the IRS to provide tax credits for insurance purchased on federal-facilitated exchanges. The appellate court also rejected the federal government's argument that adopting the plain language of Section 36B would lead to absurd results when interpreting other PPACA provisions and that the IRS' rule must be given effect in order to accomplish Congress' broad policy goals of near-universal coverage and lower health insurance premiums.

Conversely, the Fourth Circuit found that while the pertinent language of PPACA was ambiguous, the IRS' interpretation of Section 36B was based on permissible construction of the statute. Unlike the D.C. Circuit, this appellate court was primarily persuaded by the IRS rule's advancement of the broad policy goals of PPACA including near-universal coverage and determined that without the tax credits the economic framework supporting PPACA would be destroyed.

The Obama administration announced on the same day of the court decisions that the Department of Justice will request an *en banc* hearing for the *Halbig* case. If the *Halbig* decision withstands appeal, a significant amount of individuals receiving tax credits via a federally-facilitated exchange will no longer be able to receive tax credits to assist them in purchasing health insurance that is now mandatory for most people. Currently Arizona, Delaware, New Jersey, Pennsylvania, Illinois, Michigan, and West Virginia have either federal exchanges or partnership plans between the federal and state government which could be impacted by this decision. Maryland, Washington D.C. and Virginia have state exchanges which are unaffected by the D.C. Circuit ruling.

If you have any questions about the subject matter of this e-alert or about health care reform in general, please contact Ed Hammond at ehammond@clarkhill.com or (248) 988-1821; Kristi Gauthier at kgauthier@clarkhill.com or (248) 988-5854; or Doug Ellis at dellis@clarkhill.com or (412) 394-2367.