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D.C. Circuit Invalidates Critical Rule Implementing ACA Tax Credit System

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After four years of concerted efforts to implement and adapt to the wide-ranging reforms set forth in the Patient Protection and Affordable Care Act ("ACA"), the viability of the ACA's systematic approach to increasing access to healthcare was jeopardized by the D.C. Circuit's decision in the matter of *Halbig, et al. v. Burwell* (No. 14-5018; see full text of opinion *here*). At issue in *Halbig* is whether a specific provision of the ACA, now codified as Section 36B (26 U.S.C § 36B) allows the IRS to award tax credits to relatively lower-income taxpayers who purchase health insurance on the federally-facilitated "Health Insurance Marketplace" (or, for the sake of clarity, the "Federal Exchange"). The appellants in *Halbig* successfully argued that Section 36B limits the IRS's ability to award tax credits to those taxpayers who have purchased health insurance through a state-established exchange. According to the Court's ruling, taxpayers in the 36 states that have declined to form an exchange must be denied access to federal tax credits based upon Congress's "unambiguous" statutory language.

At first glance, the impact of *Halbig* may appear limited to those persons who would otherwise be eligible to receive the tax credits at issue by virtue of earning less than 400% of the applicable federal poverty level and purchasing insurance through the Federal Exchange. The systematic nature of the ACA as a taxing scheme (as described in detail by Chief Justice Roberts in his majority opinion in *National Federation of Independent Business v. Sebelius*, 132 S.Ct 2566 (2012), full text available *here*) relies on *eligibility for tax credits* as a prerequisite for enforcing the most significant aspects of the ACA – including the individual and employer mandates. As Judge Griffith acknowledged in his opinion for the 2-1 divided panel of the D.C. Circuit, the individual mandate for Americans to purchase health insurance is enforced by way of a penalty that is triggered *if and only if* the annual cost of health insurance, l*ess applicable tax credits*, does not exceed 8% of household income. Without tax credits, the cost of the cheapest available health coverage for a great many Americans will now exceed the 8% threshold – rendering the individual mandate worthless to may Americans.

The impact of *Halbig* is even more severe in view of the employer mandate. Under the ACA, employers of 50 or more people who fail to provide acceptable health coverage to full-time employees are subject to a penalty *if and only if* one of the employer's full-time employees receives an individual tax credit for having purchased insurance on an exchange. Under the Court's ruling in *Halbig*, no tax credits would be available to employees of non-compliant employers in the 36 states that did not establish their own exchanges. Without tax credits for full-time employees who are forced to purchase insurance on an exchange, the employer mandate will be eviscerated in those 36 states. Regardless of one's viewpoint as to the effectiveness and/or propriety of health coverage mandates, the ACA's mandates provide the actuarial support for lowering the cost of health coverage by bringing more healthy people into risk pools. Without mandates, Americans are free to avoid purchasing health coverage until they become sick or injured - an especially dangerous precept in light of the fact that the ACA's restrictions on denying coverage based on a preexisting condition remain unaffected by the Court's ruling.

The Court reasoned that it was perfectly rational for Congress to create a statutory scheme that is reliant on individual state government participation in the formation of Exchanges.

So how did we get to the point where a single D.C. Circuit ruling stands to jeopardize the ACA and four years of implementation efforts? At the heart of the issue is the states' refusal to create "American Health Benefit Exchanges," *i.e.* "Exchanges," as Congress intended them to do. *See* 42 U.S.C. § 18031(d). Under the ACA, it is was only in the event of the failure of a state to establish an Exchange by Jan. 1, 2014 that the federal government would step into the shoes of a state and establish an Exchange to operate within states without their own Exchanges. *See* 42 U.S.C. § 18041(c). As the ACA was drafted with the intent that states would establish their own Exchanges, certain provisions, including the statutory authority granted to the IRS to award tax credits for purchasing health coverage on the Exchange, were drafted in a manner which could be interpreted as presuming that health coverage purchases would be made on a State Exchange. Specifically, Section 36B directs the IRS to calculate tax credits based on the cost of a "qualified health plan ... enrolled in through an Exchange *established by the State*...." The ACA specifically defines "State" as excluding the federal government, therefore, giving rise to the argument that the ACA's statutory formula for calculating tax credits specifically precludes tax credits to residents of states utilizing the Federal Exchange.

Despite the statutory language of Section 36B, as it became clear that the majority of states would not create their own Exchanges, the Treasury Department promulgated regulations in May 2012 and February 2013 that would allow the IRS to offer tax credits to those otherwise eligible individuals who purchased health coverage through any Exchange – state or federal. *See* 26 C.F.R. § 1.36B-2(a). More recently, individual residents of states utilizing the Federal Exchange (who seek to avoid the individual mandate) challenged the Treasury regulations which made residents of such states eligible for tax credits, and hence, subject to the individual mandate's penalty provisions. It was the challenge to 26 C.F.R. § 1.36B-2(a), on the basis that the regulation diverges from statutory authority, that gave rise to the *Halbig* decision.

According to the interpretation of Congressional intent set forth in Judge Griffith's opinion for the Court in *Halbig*, the statutory language of Section 36B plainly evidences Congress's intent not to afford health coverage premium tax credits to residents of states utilizing the Federal Exchange. The Court reasoned that it was perfectly rational for Congress to create a statutory scheme that is reliant on individual state government participation in the formation of Exchanges. In fact, the Court's opinion uses the contrast between the statutory language, which allows the federal government to provide access to the Federal Exchange, with the language which awards tax credits only to those who purchase through a State Exchange as support for the premise that Congress could have made, and consciously decided against, a tax credit for purchasers on the Federal Exchange.

In opposition to the appellants' position, the federal government pointed to, among other arguments, the legislative history of the ACA and the "absurd results" of invalidation of the Treasury's rule. The government indicated that at no point did any lawmaker express a clear intent that the ACA's systematic approach to addressing healthcare affordability should crumble if state governments refuse to participate. The government also identified the innumerous other provisions of the ACA that would be rendered meaningless, if not inapposite to the policy objectives of the ACA, if the Treasury's rule was successfully overturned. The Court found these arguments unpersuasive. Despite a strongly-worded dissent penned by Senior Judge Edwards focusing on the political motivations of the appellants and the clear Congressional policy prerogative to affect healthcare on a nationwide basis, the Court ultimately invalidated the Treasury rule at issue.

The ruling calls into question the eligibility of millions of Americans to receive tax credits, and raises doubts as to the viability of both the individual and employer mandates. The ruling may dramatically affect enrollment in health coverage plans, especially those created specifically for the purpose of providing coverage through the Federal Exchanges. Without the affordability provided to individual purchasers via federal tax credits, and without the individual risk-spreading benefits of the mandates, many are openly questioning the continued viability of the ACA if the ruling in *Halbig* is ultimately upheld. While the statutory deficiency identified by the Court in *Halbig* could be resolved through a simple amendment to the ACA, in light of the political animosity toward the ACA, one can safely assume that in the absence of significant electoral changes, a corrective amendment is not viable.

At present, the federal government has already announced its intent seek *en banc* review of the three-judge panel's decision in *Halbig*. If unsuccessful, the federal government will assuredly appeal to the United States Supreme Court. While the Supreme Court will not be obligated to hear the government's appeal, the conflict between the D.C. Circuit's opinion on the Treasury's rule and the Fourth Circuit Court of Appeals' opinion upholding the very same rule against an identical challenge in an opinion issued on the very same day as *Halbig* substantially increases the chances that the issues raised by *Halbig* will be ripe for review by the Supreme Court.[1] Until then, the systematic threat to the ACA posed by the *Halbig* decision will be far from full or final resolution. ■

1 The Fourth Circuit's opinion in *King, et al. v. Burwell,* No. 14-1158 (July 22, 2014) upheld 26 C.F.R. § 1.36B-2(a) against a nearly identical challenge as that posed by the appellants in *Halbig*. The opinion was released approximately three hours after *Halbig* and creates an immediate and direct split between two Circuit Courts of Appeal.

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