SilverStone GROUP™

The Implications of Recent Rulings on Premium Tax Credits

(The *Halbig* and *King* Cases)

*August **2014***

***For additional information**, please contact your Account Manager or Tony Sorrentino at 402.964.5470 or tsorrentino@ssgi.com*

On July 22, 2014, two federal circuit courts of appeals rulings attracted the attention of benefit professionals and employer plan sponsors with conflicting decisions on a core provision of the Affordable Care Act (ACA). In the first decision, *Halbig v. Burwell*, the U.S. Court of Appeals for the District of Columbia Circuit (the "D.C. Circuit") struck a major blow against the ACA by holding that regulations allowing premium tax subsidies through Federal Exchanges are invalid and that subsidies may be provided only through Exchanges established by States. In the second decision, *King v. Burwell*, the U.S. Court of Appeals for the Fourth Circuit (the "Fourth Circuit") took the opposite approach, holding that the regulations are valid. If the D.C. Circuit's decision in *Halbig* ultimately prevails, it will have major implications for certain core aspects of the ACA.

This Bulletin discusses the findings of each decision, the next steps in the procedural process, the policy and political reactions, and the practical implications in the event the *Halbig* decision is not overturned, including issues relating to employer penalties, Exchanges, and related provisions.

THE LITIGATION

The IRS Rule

At issue in both cases is an Internal Revenue Service (IRS) regulation (the "IRS Rule") providing that qualified persons may receive a premium subsidy if the individual is enrolled in a qualified health plan through an "Exchange." The IRS Rule defines "Exchange" for this purpose as "an Exchange serving the individual market for qualified individuals…, regardless of whether the Exchange is established and operated by a State (including a regional Exchange or subsidiary Exchange) or by [the U.S. Department of Health and Human Services]." The IRS Rule interprets section 36B(b)(2) of the Internal Revenue Code[3] ("§ 36B(b)(2)"), as added by the ACA, which provides that the IRS is to calculate tax credits for premiums for qualified health plans "which were enrolled through an Exchange established by the State under [section] 1311 of the Patient Protection and Affordable Care Act."

The question in both cases is whether the IRS Rule is a valid interpretation of § 36B(b)(2)?

Halbig v. Burwell – the D.C. Circuit

The D.C. Circuit concluded in *Halbig v. Burwell*, that the IRS Rule is invalid. While the Court was willing to accept the government's argument that a federally facilitated exchange established under section 1321 of the ACA could be said to have been established under section 1311, it rejected the idea that the statutory language would permit such an exchange to be "an Exchange *established by the State*." The D.C. Circuit, thus, struck down the IRS Rule as contrary to the statute's plain language.

In doing so, the D.C. Circuit reasoned that:

- Other provisions of the ACA state expressly that federal territories will "be treated as a State" for purposes of establishing an exchange. "Congress knew how to provide that a non-State entity should be treated as if it were a State when it sets up an Exchange." Congress's failure to use similar language in the ACA with respect to the federal exchanges confirms that Congress did not intend to extend tax credits to individuals purchasing health insurance through federally established exchanges.
- The government's concerns about absurd results under other provisions of the ACA upon application of a plain-language reading of § 36B(b)(2) are not controlling. Accepting, for the sake of argument, the government's position that the results of a plain meaning construction of section 36B "are odd," the Court's "inquiry into the ACA's legislative history is quite narrow:"
- In the face of the statute's plain meaning – a federal Exchange is not an "Exchange established by the State" – we ask only whether the legislative history provides evidence that this literal meaning is "demonstrably at odds with the intentions" of the ACA's drafters. Unless evidence in the legislative record establishes that it is, we must hew to the statute's plain meaning, even if it compels an odd result.
- The D.C. Circuit concludes that the ACA's legislative history fails to show Congress's "precise intent." Legislative history has value only when it clearly identifies Congress's intent. Here, the legislative history is silent on Section 36B(b)(2). The plain language thus prevails because, "in the absence of any contrary indications, that text is conclusive evidence of Congress's intent."

The court's opinion in *Halbig* does not discuss how the decision affects the availability of the cost-sharing reductions that are provided to qualifying persons under section 1402 of the ACA. However, the statute provides that cost-sharing reductions are not available "with respect to coverage for any month unless the month is a coverage month with respect to which a credit is allowed to the insured (or an applicable taxpayer on behalf of the insured) under section 36B of [the Internal Revenue] Code." Thus, the decision in *Halbig* would also appear to apply to cost-sharing reductions.

King v. Burwell – the Fourth Circuit

The Fourth Circuit reached the exact opposite result in *King v. Burwell*, No. 14-1158. The Fourth Circuit upheld the IRS Rule by finding that § 36B(b)(2) is ambiguous and then deferring to the IRS's reading of the statutory language as a permissible exercise of agency discretion.[12] Specifically, the Fourth Circuit reasoned that:

- Other provisions of the ACA support the government's position that § 36B(b)(2) reaches federally established exchanges. Such provisions include the ACA's definitions section, which broadly defines the word "exchange" to include non-State Exchanges. Those provisions favor the government's interpretation of the ACA, though "only slightly." The Court acknowledges the common sense appeal of the plaintiffs/appellants' argument. As a result, "based solely on the language and context of the most relevant statutory provisions, the court cannot say that Congress's intent is so clear and unambiguous that it 'foreclose[s] any other interpretation.'"
- Congress's intent is not rendered clear from the other relevant provisions, which the government contends conflicts with the plain language interpretation advanced by plaintiffs. Statutes of ACA's size naturally have conflicts, and the mere existence of conflicts within a statute does not render the government's view as dispositive of Congress's intent.
- Nothing in the legislative history provides compelling support for either party.
- While the government has the better of the statutory construction argument(s), the Court concludes that "the statute is ambiguous and subject to at least two different interpretations."
- The IRS Rule is a reasonable exercise of agency judgment. Confronted with an ambiguous provision, the IRS "crafted a rule ensuring the credits' broad availability and furthering the goals of the law." The IRS's exercise of discretion is entitled to deference under the second step of the *Chevron* standard.

As with *Halbig*, the court's decision in *King* does not address cost-sharing reductions. However, for the reasons discussed above, the *King* decision would also appear to apply to the availability of cost-sharing reductions.

Next Steps in the Process

The government has announced that it will seek a resolution of the circuit split through an *en banc* review of the *Halbig* decision. If the D.C. Circuit grants *en banc* review on the ground that the case involves a question of exceptional importance (or involves an issue on which there is a circuit split), the government may have a reasonable likelihood of success in overturning the panel decision. This is because the Democratic appointees to the D.C. Circuit – who are more likely to look to the purpose and intent of the ACA as a whole, as opposed to taking a (plain language) approach to statutory interpretation and, thus, to uphold the IRS Rule – outnumber the Republican appointees eligible to sit *en banc* in *Halbig* seven to five. Indeed, the panel in *Halbig* consisted of two Republican appointees in the majority and one Democratic appointee who dissented from the D.C. Circuit's decision.

Even if the D.C. Circuit grants review and reverses *Halbig*, the issue remains far from settled because similar cases remain pending in other jurisdictions. The outcomes in those cases could produce decisions from the U.S. Courts of Appeals for the Seventh and Tenth Circuits.

The existence of a split among the circuits greatly increases the likelihood that the U.S. Supreme Court would grant a petition for a *writ of certiorari* and review the lower courts' interpretation of the statute. If no circuit split exists, the Supreme Court tends to take cases only when the issue is of particular importance or merits quick resolution, or if they feel the lower courts have disregarded their previous decisions.

The mandate of the D.C. Circuit in *Halbig* will not be enforceable until after the period for seeking rehearing has expired or a petition for rehearing has been decided; if a petition for *writ of certiorari* is filed with the Supreme Court, the mandate may be stayed pending disposal of the case by the Supreme Court. Until the U.S. Department of Justice exhausts its appeal of the *Halbig* decision, the Department's position is that tax credits remain available to individuals who purchased insurance through federally established exchanges

IMPLICATIONS

What exactly is a Federal Exchange?

By striking at the core of the ACA, the *Halbig* decision, if it ultimately prevails, could have a dramatic impact on the success of ACA. However, the impact may depend on the details of an issue that is not really addressed by either the *Halbig* or *King* court – what exactly is a Federal vs. a State Exchange or, more precisely, what does a State need to do to establish an Exchange? The two courts do not agree on just how many State and Federal Exchanges there are – the D.C. Circuit counts 36 Federal Exchanges, while the Fourth Circuit counts 34. The difference appears to be Idaho and New Mexico, which have State Exchanges, although enrollment takes place through www.healthcare.gov. Under *Halbig*, there may be a more thorough re-examination of just what a State needs to do in order to be considered to have established an Exchange.

Implications for Individuals, Exchanges and the Delivery System

Regardless of a State's Exchange status, a final resolution that denies premium subsidies to even part of the population otherwise eligible for them would not only impact individual consumers, who may choose to forgo coverage in the absence of financial support, but also threatens the viability of the broader Exchange marketplace. A well-functioning Exchange marketplace requires a risk pool that reflects a full range of consumer demographics. If healthy or younger individuals opt out of the ACA's coverage options, premium and participation costs may increase for others, and Exchanges themselves may fail to function efficiently.

Healthcare providers and hospitals in particular, may also be impacted by an affirmation of the *Halbig* decision. The ACA effects a reduction in federal financial support for uncompensated care (e.g., reductions in federal disproportionate share hospital (DSH) payments) because it anticipated an increase in the number of people covered by health insurance or Medicaid. Hospitals – especially in States electing not to expand their Medicaid programs and not to create Exchanges – may find that they are responsible for substantially more uninsured individuals than promised by the ACA, further weakening an already fragile safety net system in some communities.

Implications for Employers

The *Halbig* decision impacts potential liability under the employer responsibility provisions of the ACA, also known as the "pay or play" penalties, imposed under Internal Revenue Code (the "Code") section 4980H. The penalties are triggered if a full-time employee receives a premium tax subsidy ("Premium Subsidy"). Because Premium Subsidies are accessed by individuals through Exchanges based on place of residence (rather than where they work), *Halbig* means that employers could face different exposure to penalties based on where their employees live and whether there is a Federal Exchange or a State Exchange in the employee's State of residence.

Overview of Employer Penalties

The employer penalties apply to "applicable large employers" (ALEs), meaning employers with at least 50 full-time equivalent employees. In the case of employers that are members of a controlled group of entities, whether an employer is an ALE is determined by looking at the entire controlled group; however, liability for any penalties is determined separately for each applicable large employer member (ALEM), i.e., each separate employer that comprises the ALE.

Generally, Code Section 4980H imposes penalties on ALEMs for any month during a calendar year in which one or more of the employer's full-time employees are certified as having received a Premium Subsidy and if either of the following applies:

- The ALEM failed to offer minimum essential coverage (MEC) during that month to substantially all of its full-time employees and their dependent children (including adult dependent children up to age 26). In this case, the employer would be liable for the Sledgehammer Penalty (sometimes called the "fail to offer" or "4980H(a)" penalty) if even one full-time employee receives a Premium Subsidy; OR
- The ALEM offered minimum essential coverage to substantially all its full-time employees (and their dependents) during that month but the coverage was not affordable or didn't provide minimum value. In this case, the employer would be liable for the Tackhammer Penalty (sometimes referred to as the "nonqualified coverage" or "4980H(b)" penalty) with respect to full -time employees who receive a Premium Subsidy.

  As a practical matter, the Sledgehammer Penalty will typically be much greater than the Tackhammer Penalty, because, if triggered, it is based on the total number of the ALEM's full-time employees, whereas the Tackhammer penalty is limited to the number of full-time employees who receive Premium Subsidies. As a result, many employers have focused planning on at least avoiding the Sledgehammer Penalty. The penalties are calculated as follows:

  – The Sledgehammer Penalty for any month is equal to the product of one-twelfth of $2,000 ($167) multiplied by all of the ALEMs full-time employees (reduced by its allocable share of a de minimis amount).

  – The Tackhammer Penalty for any month is equal to the product of one-twelfth of $3,000 ($250) multiplied by the number of full-time employees who received a Premium Subsidy during that month, or if less, the maximum amount of the Sledgehammer Penalty.

Effect of Halbig

Because the employer penalties are triggered only if a full-time employee receives a Premium Subsidy, the decision in *Halbig*, if controlling, would have a direct impact on potential employer liabilities. The impact will vary based on the residence of the employer's employees. The following general examples illustrate the potential impact if the rationale of the Halbig decision is controlling.

For example, if all of an ALEM's employees reside in States that have not established Exchanges, then that employer would not be subject to a penalty, even if the employer does not offer coverage to any full-time employee (and their dependent children).

As another example, suppose an ALEM has employees who reside in Iowa (which has established their own State Exchange) and Nebraska (which has a federally facilitated exchange) and that the ALEM does not offer coverage to substantially all its full-time employees (and dependent children). Employees who reside in Nebraska cannot trigger the penalties under *Halbig*, because the Premium Subsidies are not available. However, if one of the full-time employees who reside in Iowa receives a Premium Subsidy, then the Sledgehammer Penalty would apply and would be calculated based on the total number of the ALEM's full-time employees, including those who reside in Iowa and those that reside in Nebraska. Note that the Sledgehammer penalty would apply even if only one full-time employee in Iowa receives a Premium Subsidy. On the other hand, the Tackhammer penalty would only apply with respect to employees who reside in States that have established an Exchange.

Thus, in general, *Halbig* adds a new element to the analysis of whether pay or play penalties may be triggered. The ultimate impact, however, will vary from employer to employer. An employer with even a few full-time employees in States that established Exchanges can still be subject to significant penalties without appropriate planning.

IN SUMMARY

Until a resolution that affirms *Halbig* is reached – a result that could take until 2015 if the U.S. Supreme Court receives and accepts a petition for *certiorari* – the Administration is unlikely to stop providing premium subsidies to those eligible for them who purchased qualified health plans through a federally facilitated exchange. And although some in Congress may seek a legislative correction that clarifies the ACA text at issue, neither the House nor the Senate appear likely to reach a consensus to secure final passage this year; the legislative environment for ACA changes is challenging and is likely to remain that way, especially in an election year.