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**TAXATION WITHOUT REPRESENTATION:
THE ILLEGAL IRS RULE TO EXPAND TAX
CREDITS UNDER THE PPACA**

Jonathan H. Adler
Michael F. Cannon

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Abstract

The Patient Protection and Affordable Care Act (PPACA) provides tax credits and subsidies for the purchase of qualifying health insurance plans on state-run insurance exchanges. Contrary to expectations, many states are refusing or otherwise failing to create such exchanges. An Internal Revenue Service (IRS) rule purports to extend these tax credits and subsidies to the purchase of health insurance in federal exchanges created in states without exchanges of their own. This rule lacks statutory authority. The text, structure, and history of the Act show that tax credits and subsidies are not available in federally run exchanges. The IRS rule is contrary to congressional intent and cannot be justified on other legal grounds. Because the granting of tax credits can trigger the imposition of fines on millions of individuals and employers, the IRS rule is likely to be challenged in court.

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I. Introduction

On March 23, 2010, President Barack Obama signed the Patient Protection and Affordable Care Act (PPACA, or “the Act”) into law.¹ The PPACA creates a complex scheme of new government regulations, mandates, subsidies, and agencies in an effort to achieve near-universal health insurance coverage. Immediately after passage, a majority of state attorneys general and numerous business and public interest groups filed suit challenging various portions of the new law, most notably the so-called “individual mandate” and Medicaid expansion. This litigation wound its way to the U.S. Supreme Court, which produced a divided ruling upholding the constitutionality of the mandate but limiting the Medicaid expansion.² This decision did not end the controversy surrounding the law.³ Additional litigation will certainly follow.⁴

The PPACA’s congressional sponsors created incentives for states to implement much of the law, and reasonably expected that states would do so.⁵ States help implement many complex

¹ See Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 244 (2010).

² See Nat’l Fed’n Indep. Bus. v. Sebelius, 567 U.S. ___ (2012) (divided Supreme Court upholds constitutionality of individual mandate as a tax but invalidates conditioning of federal Medicaid funds on state acceptance of Medicaid expansion).

³ News reports suggesting Chief John Roberts may have switched his vote after oral argument have only fueled the controversy. See Jan Crawford, *Roberts Switched Views to Uphold Health Care Law*, CBS NEWS, July 1, 2012, http://www.cbsnews.com/8301-3460_162-57464549/roberts-switched-views-to-uphold-health-care-law/?pageNum=2&tag=contentMain:contentBody.

⁴ See Michael Doyle, *It ain’t over – more legal challenges to health care law coming*, MCCLATCHY NEWSPAPERS, June 29, 2012, <http://www.mcclatchydc.com/2012/06/29/v-print/154456/it-aint-over-more-legal-challenges.html>; Reuters, *Supreme Court Health Care Ruling Just The Beginning Of Obamacare Legal Challenges*, MSNBC.COM, June 18, 2012, available at: <http://leanforward.msnbc.msn.com/news/2012/06/18/12284836-foes-plan-next-wave-of-healthcare-lawsuits>.

⁵ *Departments of Labor, Health and Human Services, Education, and Related Agencies Appropriations for 2011: Hearing Before the H. Comm. on Appropriations*, 111th Cong. 170-171 (March 10, 2010) (Statement by Kathleen

federal programs, from Medicaid to the Clean Air Act. Among other things, the PPACA encourages states to create new agencies called health insurance “Exchanges” to execute many of the law’s key features. If a state fails to create an Exchange that meets federal standards, the Act authorizes the federal government to create a “fallback” Exchange for that state. As an inducement to state officials, the Act authorizes tax credits and subsidies for certain households that purchase health insurance through an Exchange, but restricts those entitlements to Exchanges created by states. Apparently this was not inducement enough.

As of August 2012, only 15 states and the District of Columbia had taken affirmative steps to create a PPACA-compliant Exchange.⁶ Dozens of states are either dragging their heels or flatly refusing to cooperate with implementation.⁷ Contrary to initial expectations, a large number of states will not create Exchanges before the PPACA’s key provisions take effect in 2014. As Health and Human Services Secretary Kathleen Sebelius commented in February

Sebelius, Secretary, Department of Health and Human Services), *available at*: <http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg58233/pdf/CHRG-111hhrg58233.pdf> (“We have already had lots of positive discussions, and States are very eager to do this. And I think it will very much be a State-based program.”); Max Baucus, Chairman of Senate Finance Committee, Statement at Health Care Reform Newsmaker Series: Sen. Max Baucus, Kaiser Family Foundation, Families USA and the National Federation of Independent Business (May 21, 2009), at 23, *available at*: http://www.kff.org/healthreform/upload/052109_Baucus_newsmakers_transcript.pdf (“States will still be able to make a lot of decisions, perhaps, but there will be significant measures left to states, but still in a way where Americans will know, that in whatever state they live, that they’re going to get quality, they’re getting affordable, and access to affordable, quality healthcare.”).

⁶ Kaiser Family Foundation, State Health Facts, *State Action Toward Creating Health Insurance Exchanges* (Aug. 1, 2012), <http://www.statehealthfacts.org/comparemaptable.jsp?ind=962&cat=17> (Thirteen states have enacted legislation (including DC, MA and UT). Three others, Kentucky, New York and Rhode Island, have established exchanges through executive action). PRICEWATERHOUSECOOPER, IMPLICATIONS OF THE US SUPREME COURT RULING ON HEALTH CARE 8 (2012), *available at*: <http://pwchealth.com/cgi-local/hregister.cgi/reg/implications-of-the-US-Supreme-Court-ruling-on-healthcare.pdf>.

⁷ See J. Lester Feder and Jason Millman, *Exchanges Hit Roadblocks in Red States*, POLITICO, Apr. 18, 2012, <http://www.politico.com/news/stories/0412/75331.html>; Elise Viebeck, *Fifteen Governors Reject or Leaning Against Expanded Medicaid Program*, THE HILL’S HEALTHWATCH, July 3, 2012, <http://thehill.com/blogs/healthwatch/health-reform-implementation/236033-fifteen-governors-reject-or-leaning-against-expanded-medicaid-program>.

2012, the federal government could be responsible for running Exchanges in fifteen to thirty states.⁸ Subsequent reports suggest the final number may be even higher.⁹

This apparent miscalculation creates a number of problems for implementation of the PPACA. The tax credits and subsidies for the purchase of qualifying health insurance plans in state-run Exchanges serve as more than just an inducement to states. These entitlements also operate as the trigger for enforcement of the Act’s “employer mandate.” As a consequence, that mandate is effectively unenforceable in states that decline to create an Exchange. The tax credits further play a role in the enforcement of the Act’s “individual mandate,” such that a state’s decision not to create an Exchange exempts more than half of its uninsured residents from that mandate.¹⁰ Because such a large number of states may decline to create Exchanges of their own, it may be difficult to implement the law as supporters had hoped.

A final Internal Revenue Service (IRS) rule issued on May 18, 2012, attempts to fix this problem by extending eligibility for tax credits and cost-sharing subsidies to those who purchase qualifying insurance plans in *federally* run Exchanges.¹¹ The problem is that the PPACA precludes the IRS from issuing tax credits in federal Exchanges. The plain text of the Act only authorizes premium-assistance tax credits and cost-sharing subsidies for those who purchase plans on state-run Exchanges, and the IRS rule’s attempt to offer them to other individuals

⁸ See J. Lester Feder, *Sebelius: Exchange funding request was anticipated*, POLITICO PRO, Feb. 14, 2012, <https://www.politicopro.com/go/?id=9220> [subscription only] (“We don’t know if we’re going to be running an exchange for 15 states, or 30 states.”).

⁹ See J. Lester Feder and Jason Millman, *Few States Set for Health Exchanges*, POLITICO, May 21, 2012, <http://www.politico.com/news/stories/0512/76596.html> (“Many insurance experts and health policy consultants predict only a dozen or so states will be ready to run exchanges on their own — and a few say that projection may be too sunny”).

¹⁰ We are indebted to Richard Urich for alerting us to the relationship between state-established Exchanges and the individual mandate’s affordability exemption.

¹¹ Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 76 FEDERAL REGISTER 50935 (August 17, 2011), available at: <http://www.gpo.gov/fdsys/pkg/FR-2011-08-17/pdf/2011-20728.pdf>.

cannot be legally justified on other grounds. In other words, the IRS is attempting to create two entitlements not authorized by Congress, and in the process, to tax employers and individuals whom Congress did not authorize the agency to tax.

It may be somewhat surprising that the PPACA contains such a gaping hole in its regulatory scheme. We were both surprised to discover this flaw in the law, and initially characterized it as a “glitch.”¹² Yet our further research demonstrates this feature of the law was intentional and purposeful, and that the IRS’s rule has no basis in law. This supposed fix is actually an effort to rewrite the law and provide for something Congress never enacted, and indeed that PPACA’s authors intentionally chose not to include in the law.

This article explains the importance of the law’s limitation on the availability of tax credits for health insurance for implementation of the PPACA and details the case for and against the IRS rule. Part II provides a brief overview of the PPACA’s legislative history and explains the regulatory structure the Act creates to govern private health insurance markets—paying particular attention to the instability the law introduces into those markets, the role of tax credits and subsidies in mitigating that instability, and the central role of health insurance “Exchanges.” Part III describes the IRS rule and the agency’s justification for it. Part IV shows how the IRS rule is contrary to the text, structure, purpose, and history of the PPACA. Part V identifies and evaluates other potential legal rationales for the IRS rule and finds them wanting. Part VI explains that while an IRS rulemaking expanding the eligibility of tax credits or subsidies beyond that authorized by Congress would normally escape judicial review, the interactions of the tax credit provisions with the law’s employer and individual mandates

¹² See, e.g., Jonathan H. Adler and Michael F. Cannon, *Another ObamaCare Glitch*, WALL ST. J., Nov. 16, 2011. The authors were first made aware of this aspect of the PPACA by a presentation by attorney Thomas Christina at the American Enterprise Institute in December 2010. See Thomas Christina, *What to Look for Beyond the Individual Mandate (And How to Look for It)* (Dec. 6, 2010), available at: <http://www.aei.org/files/2010/12/06/Christina20101206.pdf>.

provides a basis for Article III standing to challenge the IRS rule. In other words, this question is likely to be resolved in federal court.

II. The PPACA

What we now call the PPACA is the product of three different bills, two of which originated in the Senate and a third which made limited amendments to the final Senate bill at the behest of the House of Representatives. In 2009, two Senate committees reported major health care legislation. On September 17, the Health, Education, Labor, and Pensions (HELP) Committee approved the “Affordable Health Choices Act” (S. 1679).¹³ On October 19, the Senate Finance Committee approved the “America’s Healthy Future Act of 2009” (S. 1796).¹⁴ The two Senate bills shared many features. Before either bill reached the Senate floor, Senate Majority Leader Harry Reid (D-NV) assembled the chairmen of those committees plus congressional and White House staff in his office in the U.S. Capitol, where they merged the two committee-reported bills into the Patient Protection and Affordable Care Act.¹⁵

Though Senate Democrats held a 60-seat majority—the minimum necessary to break a Republican filibuster—Senator Reid had difficulty collecting yea votes from every member of

¹³ U.S. Library of Congress: Thomas, *Bill Summary & Status, 111th Congress, S. 1697, All Information*, 2009, <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:SN01679:@@L&summ2=m&>; Affordable Health Choices Act, S. 1697, 111th Cong. (2009), <http://www.gpo.gov/fdsys/pkg/BILLS-111s1679pcs/pdf/BILLS-111s1679pcs.pdf>.

¹⁴ U.S. Library of Congress: Thomas, *Bill Summary & Status, 111th Congress, S. 1796, All Information*, 2009, <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:SN01796:@@L&summ2=m&>; America’s Healthy Future Act of 2009, S. 1796, 111th Cong. (2009), <http://www.gpo.gov/fdsys/pkg/BILLS-111s1796pcs/pdf/BILLS-111s1796pcs.pdf>.

¹⁵ David M. Herszenhorn and Robert Pear, *White House Team Joins Talks on Health Care Bill*, N.Y. TIMES, Oct. 14, 2009, <http://www.nytimes.com/2009/10/15/health/policy/15health.html> (quoting Senate Majority Leader Harry Reid (D-NV): “This is legislating at its best.”).

his caucus.¹⁶ Once he had corralled all 60 votes, Senate Democrats broke the Republican filibuster. The new Patient Protection and Affordable Care Act cleared the U.S. Senate before sunrise on December 24, 2009, without a vote to spare.¹⁷

Congressional Democrats had intended to have a conference committee merge the PPACA with the “Affordable Health Care for America Act” (H.R. 3962) that had passed the House of Representatives in November.¹⁸ Had this occurred, the PPACA might look quite different than it does today. But in January 2010, Republican Scott Brown won a special election to fill the seat vacated by the death of Sen. Edward Kennedy (D-MA). Brown’s victory shifted the political terrain. It gave Senate Republicans the 41st vote necessary to filibuster a conference report on the House and Senate bills.

As a result, House and Senate Democrats abandoned a conference committee in favor of a novel strategy. House Democrats agreed to pass the PPACA exactly as it had passed the Senate, but only upon receiving assurances that after the House amended the PPACA through the “budget reconciliation” process, the Senate would immediately approve those amendments. Since Senate rules protect reconciliation bills from a filibuster, the PPACA’s supporters needed only 51 votes to pass the House’s “reconciliation” amendments. The downside of this strategy was that the rules governing budget reconciliation limited the amendments House Democrats

¹⁶ Brian Montopoli, *Tallying the Health Care Bill's Giveaways*, CBS NEWS, Dec. 21, 2009, http://www.cbsnews.com/8301-503544_162-6006838-503544.html.

¹⁷ United States Senate, *Vote Summary: On Passage of the Bill (H.R. 3590 as Amended)*, (Dec. 24, 2009) http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=1&vote=00396.

¹⁸ U.S Library of Congress: *Thomas, Bill Summary & Status, 111th Congress, H.R. 3962, CRS Summary*, (Nov. 7, 2009), <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:HR03962:@@D&summ2=1&>; Affordable Health Care for America Act, H.R. 3962, 111th Cong. (2009), <http://www.gpo.gov/fdsys/pkg/BILLS-111hr3962pcs/pdf/BILLS-111hr3962pcs.pdf>.

could make.¹⁹ Supporters opted for an imperfect bill – that is, a bill that did not accomplish all they may have set out to do, but for which they had the votes – over no bill at all.

The Act signed into law by President Obama and the law that the IRS rule purports to implement—the PPACA—is thus a hybrid of the two Senate-committee-reported bills, as amended by the Health Care and Education Reconciliation Act of 2010 (HCERA).²⁰ This history, and the need to resort to the reconciliation process to pass the final law, helps explain why the final legislation looks as it does, and why the Act does not conform with the hopes or expectations of some of its supporters.

III. The PPACA’s Regulatory Structure

The PPACA attempts to achieve near-universal health insurance coverage through an interdependent system of government price controls, mandates, and subsidies. In order to understand the significance of the IRS rule, it is important to understand the role of health insurance exchanges and how exchanges were intended to complement the other reforms enacted by the PPACA.

A. A Three-Legged Stool

¹⁹ John Carney, *How Does Reconciliation Work in Congress?*, BUSINESS INSIDER, Jan. 17, 2010, http://articles.businessinsider.com/2010-01-17/news/29990286_1_41st-vote-filibuster-vote-republican-filibuster; Alan Greenblatt, *Senate Faces Slog Over Health Bill Amendments*, NPR, Mar. 21, 2010, <http://www.npr.org/templates/story/story.php?storyId=124993274>.

²⁰ Congress has further amended PPACA through subsequent legislation. Those amendments do not affect the matter at hand.

Among the central features of the PPACA are new regulatory controls limiting medical underwriting by health insurance companies.²¹ Specifically, the Act requires carriers to charge individuals of a given age the same premium, regardless of their health status.²² This type of government price control, known as “community rating,” reduces premiums for those with pre-existing conditions but increases premiums for low-risk households, and thereby encourages healthy households to wait until they fall ill to purchase health insurance.²³ Such price controls can produce a vicious cycle of adverse selection: the influx of high-risk consumers and exodus of low-risk consumers cause premiums to rise, which leads additional low-risk customers to drop coverage, leading to further price increases, and so on.²⁴ In other contexts, community-rating price controls have caused comprehensive health insurance plans and even entire carriers to exit certain health insurance markets,²⁵ often to the point of market collapse.²⁶

²¹ Mark A. Hall, *The Factual Bases for Constitutional Challenges to the Constitutionality of Federal Health Insurance Reform*, 38 N. KY. L. REV. 457, 464 (2011) (“prohibiting medical underwriting” is among the PPACA’s “core provisions”).

²² The Act prohibits carriers from adjusting premiums for any reason other than age (allowable variation: a 3 to 1 ratio for adults only); family size (two categories: individual or family); smoking status (carriers may charge smokers up to 50 percent more than nonsmokers); or by geographic “rating areas.” Carriers may not adjust premiums according to an applicant’s health status or sex. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Section 1201, 124 Stat. 155 (2010).

²³ The Act’s “guaranteed issue” provisions also require carriers to offer health insurance to all applicants, regardless of health status.

²⁴ Thomas C. Buchmueller, *Consumer Demand for Health Insurance*, NBER REPORTER (2006), available at: <http://www.nber.org/reporter/summer06/buchmueller.html>. (Discussing health insurance exchanges at Harvard University and the University of California system: “One factor contributing to adverse selection in the UC and Harvard cases is that, in each system, premium contributions faced by employees and premium payments to plans were ‘community rated’ – that is, they did not vary with the risk characteristics of those being insured. As discussed earlier, one result is thus that the most generous plan faced an adverse selection death spiral.”)

²⁵ Thomas C. Buchmueller, *Consumer Demand for Health Insurance*, NBER REPORTER (Summer 2006), available at: <http://www.nber.org/reporter/summer06/buchmueller.html>.

²⁶ Brief for Texas Public Policy Foundation, et al. as Amici Curiae Supporting Petitioners, Nat’l Fed. of Indep. Business v. Sebelius, 567 U.S. ___ (2012) Nos. 11-393 & 11-400, (“Before Congress took up health care reform in 2009, a handful of states had experimented with major health insurance reforms including guaranteed issue and some form of community rating compression, focused on the individual insurance market. These reform efforts generally had disastrous effects: States experienced adverse selection spirals, with increased numbers of uninsured, large premium increases, and insurers exiting the individual market.” (internal citations omitted)). U.S. SENATE, COMM. ON HEALTH, EDUCATION, LABOR AND PENSIONS, RANKING MEMBER REPORT: HEALTH CARE REFORM LAW’S IMPACT ON CHILD-ONLY HEALTH INSURANCE POLICIES (Aug. 2, 2011), <http://help.senate.gov/imo/media/doc/Child->

To combat the instability introduced by its community-rating price controls, the Act imposes an “individual mandate” that requires nearly all Americans to purchase a health insurance policy covering a minimum package of “essential” coverage.²⁷ Failure to comply may result in a penalty paid to the IRS.²⁸ In addition, the Act imposes an “employer mandate” that requires employers to offer “essential” and “affordable” health benefits to all full-time employees and their dependents.²⁹ Failure may result in penalties against the employer.³⁰ The combined effect of the PPACA’s price controls and individual mandate is that health-insurance premiums could increase by as much as 100 percent or more for some young and healthy households.³¹

Given the burden those higher premiums will impose on low-income households, the Act offers refundable “premium assistance” tax credits to households with incomes between 100 and

[Only%20Health%20Insurance%20Report%20Aug%20202,%202011.pdf](#); CENTERS FOR MEDICARE AND MEDICAID SERVICES, OFFICE OF THE ACTUARY, ESTIMATED FINANCIAL EFFECTS OF THE “PATIENT PROTECTION AND AFFORDABLE CARE ACT,” AS AMENDED 14 (Apr. 22, 2010), https://www.cms.gov/Research-Statistics-Data-and-Systems/Research/ActuarialStudies/downloads/PPACA_2010-04-22.pdf (“Although Title VIII includes modest work requirements in lieu of underwriting and specifies that the program is to be “actuarially sound” and based on “an actuarial analysis of the 75-year costs of the program that ensures solvency throughout such 75-year period,” there is a very serious risk that the problem of adverse selection will make the CLASS program unsustainable.”).

²⁷ See *Nat’l Fed’n Indep. Bus. v. Sebelius*, 567 U.S. __ (2012).

²⁸ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Section 1501, 124 Stat. 244 (2010). According to the Supreme Court, this penalty is, in actuality, a “tax.” See *Nat’l Fed’n Indep. Bus.*, 567 U.S. at __.

²⁹ *Id.* § 1513 revised by the Health Care and Education Reconciliation Act of 2010 (Defining an “applicable large employer” as one “who employed an average of at least 50 full-time employees on business days during the preceding calendar year.”).

³⁰ *Id.*

³¹ JONATHAN GRUBER ET AL., THE IMPACT OF THE ACA ON WISCONSIN’S HEALTH INSURANCE MARKET (July 18, 2011). (“Prior to tax subsidies, 41% of the market will receive a premium increase that is higher than 50%...54% of the members receiving greater than a 50% premium increase are age 29 or under.”); Email Correspondence from Dennis Smith, Wisconsin Secretary of Health Services, (Jan. 13, 2012) (Citing supplemental findings from Gruber et al.: “Another way to look at the data is to just look at the 1% of single policies that see the highest increases after accounting for the tax subsidy. In this case these ‘top’ 1% see an average increase of 126%.”); JEREMY D. PALMER, JILL S. HERBOLD, AND PAUL R. HOUCHEMS, MILLIMAN CLIENT REPORT: ASSIST WITH THE FIRST YEAR OF PLANNING FOR DESIGN AND IMPLEMENTATION OF A FEDERALLY MANDATED AMERICAN HEALTH BENEFITS EXCHANGE IN THE INDIVIDUAL MARKET 7 (2011), available at: <http://www.ohioexchange.ohio.gov/Documents/MillimanReport.pdf>, (“In the individual market, a healthy young male (with benefit coverage at the market average actuarial value pre and post-ACA) may experience a rate increase of between 90% and 130%.”).

400 percent of the federal poverty level.³² The Act further offers “cost-sharing subsidies” that enable households between 100 and 250 percent of poverty to obtain, at no additional cost to themselves, more than the mandatory minimum level of coverage.³³ This premium assistance is only available for the purchase of insurance in health care exchanges, however.³⁴

These features of the PPACA’s regulatory scheme are interdependent. An apt metaphor is that of a three-legged stool: removing any of the three above-mentioned “legs”—the price controls, the individual mandate, or the tax credits and subsidies—could cause the structure to collapse. Remove the price controls, and premiums for high-risk households would increase dramatically; those households would have a more difficult time complying with the individual mandate. Remove either the individual mandate or the tax credits, and the Act’s price controls would further threaten the viability of health insurance markets by pushing low-income/low-risk households to exit the market.

B. Exchanges, Tax Credits & the Employer Mandate

Health insurance exchanges (“Exchanges” hereafter) play an essential role in PPACA’s regulatory scheme. As the Department of Health and Human Services explains, “Exchanges are integral to the Affordable Care Act’s goals of prohibiting discrimination against people with pre-

³² Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1401, 124 Stat. 119, 213-214 (2010) Revised by Sec. 1001(a)(1)(A) of the Health Care and Education Reconciliation Act (HCERA).

³³ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1402, 124 Stat. 119, 221-222 (2010) Revised by Sec. 1001(a)(2) of HCERA.

³⁴ *See infra*

existing conditions and insuring all Americans.”³⁵ Specifically, Exchanges are government agencies that oversee the buying and selling of health insurance within a state,³⁶ monitor carriers’ compliance with the Act’s health-insurance price controls, implement measures to mitigate the perverse incentives created by the Act’s price controls;³⁷ report to the IRS on whether individuals are complying with the individual mandate;³⁸ and distribute hundreds of billions of dollars in government subsidies to private health insurance companies.³⁹

Like the individual and employer mandates, Exchanges help to limit how much of the cost of the Act’s insurance expansion appears in the federal budget. By requiring households to give money directly to insurance companies, the individual mandate keeps those transactions off

³⁵ CENTERS FOR MEDICARE & MEDICAID SERVICES, CENTER FOR CONSUMER INFORMATION AND INSURANCE OVERSIGHT, GENERAL GUIDANCE ON FEDERALLY-FACILITATED EXCHANGES 3 (May 16, 2012), http://cciio.cms.gov/resources/files/FFE_Guidance_FINAL_VERSION_051612.pdf.

³⁶ See Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1311(d), 124 Stat. 119, 173 (2010) (defining an Exchange as “a governmental agency or nonprofit entity that is established by a State.”).

³⁷ Timothy S. Jost, *Implementing Health Reform: A Final Rule On Health Insurance Exchanges*, HEALTH AFFAIRS BLOG, Mar. 13, 2012, <http://healthaffairs.org/blog/2012/03/13/implementing-health-reform-a-final-rule-on-health-insurance-exchanges/>. In this essay, Jost explains that state-run Exchanges

must ensure that [qualified health plan] service areas cover at least a county except under exceptional circumstances to discourage redlining. The final rule QHP standards require QHPs to meet network adequacy standards. Specifically, plans must maintain ‘a network that is sufficient in number and types of providers, including providers that specialize in mental health and substance abuse services, to assure that all services will be accessible without unreasonable delay’ and include essential community providers. QHPs...cannot employ marketing practices or benefit designs that will discourage enrollment of individuals with significant health needs.

Id.

³⁸ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1311, 124 Stat. 119, 177 (2010).

³⁹ *Executive Business Meeting to Consider an Original Bill Providing for Health Care Reform: Hearing before the S. Comm. on Finance*, 111th Cong. (2009) (Testimony of Tom Barthold, Chief of Staff of the Joint Committee on Taxation) (“in terms of the direct payment, the mark would direct the payments go directly to the insurance provider”); see also *id.* (Testimony of Douglas W. Elmendorf, Director, Congressional Budget Office):

On a preliminary basis, CBO and JCT estimate that the proposal’s specifications affecting health insurance coverage would result in a net increase in federal deficits of \$518 billion over fiscal years 2010 through 2019. That estimate primarily reflects \$345 billion in additional federal outlays for Medicaid and CHIP and \$461 billion in federal subsidies that would be provided to purchase coverage through the new insurance exchanges and related spending.

the government’s books.⁴⁰ Likewise, the employer mandate requires employers to purchase coverage for their workers, thereby removing those transactions from the federal budget and even household budgets.⁴¹ In this way, the PPACA achieves its redistributionist goals off-budget.

Similarly, Exchanges reduce the Act’s impact on the federal budget by limiting eligibility for tax credits and subsidies. Allowing all households within the relevant income ranges to claim these entitlements would dramatically increase the federal deficit and significantly disrupt existing employer-sponsored insurance arrangements. The PPACA’s authors therefore offered these entitlements only to certain households that purchase a qualified health plan through an Exchange. In addition to household-income criteria, individuals are eligible for tax credits only if they are not Medicaid-eligible and do not receive an offer of “essential” and “affordable” self-only health coverage from an employer.⁴²

⁴⁰ See Michael F. Cannon, *The \$1.5 Trillion Fraud*, NATIONAL REVIEW (ONLINE), Nov. 6, 2009, [http://www.cato.org/publications/commentary/\\$15-trillion-fraud](http://www.cato.org/publications/commentary/$15-trillion-fraud). (“President Clinton’s ill-fated health plan had an individual mandate, too. Back in 1994, the CBO decided that since ‘the mandatory premiums . . . would constitute an exercise of sovereign power,’ the agency would treat all premiums as federal revenues, including them in the federal budget. That revealed to the public the full cost of Clinton’s health plan. Clinton’s secretary of health and human services, Donna Shalala, called the CBO’s decision ‘devastating.’ Journalist Ezra Klein writes that it ‘helped kill the bill.’”). See also Michael F. Cannon, *Bland CBO Memo, or Smoking Gun?* CATO@LIBERTY, Dec. 16, 2009, <http://www.cato-at-liberty.org/bland-cbo-memo-or-smoking-gun/> (explaining how the PPACA’s authors carefully avoided having the CBO include the mandatory premiums in federal budgets).

⁴¹ The money employers use to purchase employee health benefits comes out of employees’ cash compensation rather than profits. See JONATHAN GRUBER, *Health Insurance and the Labor Market*, JOSEPH NEWHOUSE AND ANTHONY CULYER, EDS., *THE HANDBOOK OF HEALTH ECONOMICS*. AMSTERDAM: NORTH HOLLAND, P. 645-706.

⁴² The PPACA defines “essential” as coverage that satisfies the Act’s individual mandate, and defines “affordable” as when the explicit (i.e., employee-paid) portion of the premium is less than 9.5 percent of household income. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1401, 124 Stat. 119, 216-217 (2010) Revised by Sec. 1001(a)(2)(A) of HCERA. According to the IRS:

Consistent with these statutory provisions, the proposed regulations provide that an employer-sponsored plan also is affordable for a related individual for purposes of section 36B if the employee’s required contribution for self-only coverage under the plan does not exceed 9.5 percent of the applicable taxpayer’s household income for the taxable year, even if the employee’s required contribution for the family coverage does exceed 9.5 percent of the applicable taxpayer’s household income for the year.

Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 76 FEDERAL REGISTER 50935 (Aug. 17, 2011), available at: <http://www.gpo.gov/fdsys/pkg/FR-2011-08-17/pdf/2011-20728.pdf>.

Offering tax credits and subsidies within health insurance Exchanges, however, creates an incentive for employers to drop their health benefits so that their workers can gain access to them. If employers did so in large numbers, the PPACA’s budgetary footprint would grow.⁴³ The employer mandate attempts to prevent such employer “dumping.” It penalizes employers with more than 50 workers if they fail to offer a minimum package of “essential” and “affordable” health benefits to all employees. By compelling employers to offer health benefits, and thereby restricting access to the Exchanges, the employer mandate reduces the federal budgetary impact of the Act’s insurance expansion and reduces disruption to existing insurance arrangements.⁴⁴

Exchanges, in turn, play an essential role in enforcing the employer mandate. Before the IRS may levy a penalty against an employer, (1) the employer must fail to offer “minimum essential coverage” to all full-time employees and their dependents, and (2) one of the employer’s full-time employees must enroll in a qualified health plan through an Exchange “to which an applicable premium tax credit or cost-sharing reduction is allowed or paid with respect to the employee.”⁴⁵ If an employer fails to offer “essential” health coverage, the Act fines the

⁴³ This would also further undermine the claim made by the PPACA’s proponents that it would not cause people to lose their existing health insurance. *See e.g., Barack Obama promises you can keep your health insurance, but there’s no guarantee*, POLITIFACT, Aug. 11, 2009, <http://www.politifact.com/truth-o-meter/statements/2009/aug/11/barack-obama/barack-obama-promises-you-can-keep-your-health-ins/> (Quoting President Barack Obama: “If you like your health care plan, you can keep your health care plan.”)

⁴⁴ Some analysts predict worker exodus and employer dumping will occur despite the PPACA’s attempts to prevent it. DOUGLAS HOLTZ-EAKIN & CAMERON SMITH, LABOR MARKETS AND HEALTH CARE REFORM: NEW RESULTS (May 2010), available at: <http://americanactionforum.org/files/LaborMktsHCRAAF5-27-10.pdf>. *But see* LINDA BLUMBERG ET AL., “WHY EMPLOYERS WILL CONTINUE TO PROVIDE HEALTH INSURANCE: THE IMPACT OF THE AFFORDABLE CARE ACT (2011), available at: <http://www.urban.org/UploadedPDF/412428-The-Impact-of-the-Affordable-Care-Act.pdf>; *see also* CONGRESSIONAL BUDGET OFFICE, UPDATED ESTIMATES FOR THE INSURANCE COVERAGE PROVISIONS OF THE AFFORDABLE CARE ACT (2012), available at: <http://cbo.gov/sites/default/files/cbofiles/attachments/03-13-Coverage%20Estimates.pdf>; CONGRESSIONAL BUDGET OFFICE, CBO AND JCT’S ESTIMATES OF THE EFFECTS OF THE AFFORDABLE CARE ACT ON THE NUMBER OF PEOPLE OBTAINING EMPLOYMENT-BASED HEALTH INSURANCE (2012), available at: http://cbo.gov/sites/default/files/cbofiles/attachments/03-15-ACA_and_Insurance_2.pdf.

⁴⁵ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1513, 124 Stat. 119, 253 (2010). This language was clearly intended to cover a circumstance where the subsidy was allowed but not paid. It obviously does not create a situation where a subsidy could be paid even if it is not allowed.

employer \$2,000 for every full-time employee who receives or is eligible for a tax credit through an Exchange (after exempting the first 30 employees). If an employer offers coverage that is “essential” but not “affordable,” the Act fines the employer either \$3,000 for each employee who receives or is eligible for a tax credit through an Exchange, or the penalty for not offering “essential” coverage, whichever is less.⁴⁶ Employer groups have expressed concern about both the size and the unpredictability of these penalties.⁴⁷

C. Tax Credits & the Individual Mandate

Exchanges also play a key role in the enforcement of the individual mandate. Subject to certain exemptions, the PPACA requires all U.S. residents to obtain a minimum level of health insurance coverage or pay a tax penalty.⁴⁸ When fully phased-in by 2016, penalties will be either a flat fee of \$695 (singles) to \$2,085 (families of four or more) or 2.5 percent of income in excess of the income-tax filing threshold, whichever is greater, up to a limit of the nationwide average premium of all “bronze” level health plans available to the taxpayer’s age and household

⁴⁶ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1513, 124 Stat. 119, 253-256 amended by HCERA (adds Sec. 4980H to the Internal Revenue Code).

⁴⁷ *February Outlook: Business and Health Reform*, COBANK, <http://www.cobank.com/Newsroom-Financials/CoBank-News-Feed/February-Outlook.aspx>. (Last visited July 10, 2012) (Quoting Robert Graboyes, Senior Fellow for Health and Economics at the National Federation of Independent Business Research Foundation):

What makes it very difficult for businesses is that the penalties involve so much that is outside of their control or even outside of their view. Let’s say you’re married with two children and you and your wife together earn \$100,000. Now your wife’s income drops a bit, and you’re below \$89,000. Your employer and your wife’s employer will both be slammed with a fine. I have jokingly referred to this as the ‘employee’s spouse’s uncle tax,’ because it is literally true that an employer could be fined because one of its employees has a spouse who has an elderly uncle who moves into their spare bedroom, thereby increasing family size.

⁴⁸ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1501, 124 Stat. 119, 242-250 amended by HCERA (adds Sec. 5000A to the Internal Revenue Code).

size.⁴⁹ One estimate posits the national average premium for bronze plans will be \$7,779 for a single 55 year old and \$18,085 for a family of four with a 55 year old head of household.⁵⁰

The Act exempts taxpayers from that penalty if their “required contribution” to the cost of health insurance exceeds 8 percent of household income.⁵¹ In the case of a household that does not have an offer of “essential” and “affordable” coverage from an employer, the “required contribution” is the difference between the premium for the lowest-cost plan available to the household through an Exchange, and any premium-assistance tax credit for which the household is eligible.⁵² Many households that would otherwise be exempt from the mandate will therefore be penalized because their eligibility for tax credits will bring their “required contribution” below 8 percent of household income.

D. Tax Credits & State-Run Exchanges

The PPACA’s authors envisioned that each state would have its own health insurance Exchange, operated by state officials. As President Obama explained shortly after signing the PPACA, “by 2014, each state will set up what we’re calling a health insurance exchange.”⁵³ The

⁴⁹ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, I.R.C § 5000A(b) and (c), 124 Stat. 119, 244-246 (amended by PPACA Sec. 10106 (b), 124 Stat. 119, 909-910).

⁵⁰ Letter from Douglas W. Elmendorf, Director, Congressional Budget Office, to John Boehner, Speaker of the House, Direct Spending and Revenue Effects of H.R. 6079, the Repeal of Obamacare Act, as Passed by the House of Representatives on July 11, 2012 (July 24, 2012), p. 11, *available at*: <http://www.cbo.gov/sites/default/files/cbofiles/attachments/43471-hr6079.pdf>.

⁵¹ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, I.R.C § 5000A(e)(1)(A), 124 Stat. 119, 246-247 (2010).

⁵² Patient Protection and Affordable Care Act, Pub. L. No. 111-148, I.R.C § 5000A(e)(1)(B)(ii), 124 Stat. 119, 247 (2010).

⁵³ Barack Obama, U.S President, Remarks on Health Insurance Reform in Portland, Maine (April 1, 2010), *available at*: <http://www.whitehouse.gov/the-press-office/remarks-president-health-insurance-reform-portland-maine>. *See also*, Nat’l Fed’n Indep. Bus. v. Sebelius, 567 U.S. at __ (2012) (Scalia, Kennedy, Thomas, and Alito, JJ. dissenting) (“The ACA requires each State to establish a health insurance ‘exchange.’”).

PPACA does not force states to create Exchanges, however. Though the Act declares that each state “shall” create an Exchange and lays out rules for state-run Exchanges,⁵⁴ it does not and could not mandate that states establish one.⁵⁵ A direct command that state governments assist in the implementation of a federal regulatory scheme would constitute unconstitutional commandeering.⁵⁶ If Congress believes state cooperation is necessary to facilitate the implementation of a federal program, it must create incentives for state action. The Supreme Court has explained there are “a variety of methods, short of outright coercion, by which Congress may urge a State to adopt a legislative program consistent with federal interests.”⁵⁷ Among other things, the federal government may offer states financial assistance or threaten to implement the program directly if the state refuses to go along. The use of such incentives to induce state cooperation is often referred to as “cooperative federalism”⁵⁸ and is quite common. In the PPACA, Congress used such “cooperative” measures to encourage state creation of health insurance exchanges.

Though the Act provides that states “shall” create their own exchanges, it actually gives states a choice. Section 1311 declares, “Each State shall, not later than January 1, 2014,

⁵⁴ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1311, 124 Stat. 119, 173 (2010) (“Each state shall, no later than January 1, 2014, establish an American Health Benefit Exchange (referred to in this title as an ‘Exchange’) for the State . . .”).

⁵⁵ See Jonathan H. Adler, *Cooperation, Commandeering or Crowding Out? Federal Intervention and State Choices in Health Care Policy*, 20 KAN. J.L. & PUB. POL’Y 199 (2011); see also Michael F. Cannon, *Will States Lose Medicaid Funds If They Fail to Create an ObamaCare ‘Exchange’?* CATO@LIBERTY, Feb. 6, 2012, <http://www.cato-at-liberty.org/will-states-lose-medicare-funds-if-they-fail-to-create-an-obamacare-exchange/>.

⁵⁶ See *Printz v. United States*, 521 U.S. 898, 925 (1997) (“the Federal Government may not compel the states to implement, by legislation or executive action, federal regulatory programs.”); *New York v. United States*, 505 U.S. 144 (1992).

⁵⁷ *New York*, 505 U.S. at 167.

⁵⁸ *Id.* (“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 . . . This arrangement . . . has been termed “a program of cooperative federalism.”).

establish an American Health Benefit Exchange (referred to in this title as an ‘Exchange’)” and lays out rules for state-run Exchanges.⁵⁹ Among the “requirements” for purposes of Section 1311, an Exchange must be “a governmental agency or nonprofit entity that is established by a State.”⁶⁰ Section 1304(d) clarifies the meaning of “a state”: “In this title, the term ‘State’ means each of the 50 States and the District of Columbia.”⁶¹

If a state fails to create an Exchange under Section 1311, the Act authorizes the federal Department of Health and Human Services to create an Exchange for that state.⁶² Specifically, Section 1321 requires the HHS Secretary to “establish and operate” an Exchange within any state that either fails to create an exchange or fails to implement the PPACA’s health insurance regulations to the Secretary’s satisfaction. Section 1321 thus requires a federal “fallback” for states that do not create exchanges of their own.

In order to make health insurance plans offered on state Exchanges more affordable for consumers, the PPACA provides tax credits for the purchase of qualifying health insurance plans on such Exchanges. Specifically, Section 1401 adds a new Section 36B to the Internal Revenue Code that authorizes refundable “premium assistance tax credits” for the purchase of qualifying health insurance plans in exchanges established by states under Section 1311.⁶³ These are “refundable” tax credits, meaning that in many cases the credit does not just reduce tax liability but also results in government payouts—initially to taxpayers, but ultimately to private insurance

⁵⁹ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1311, 124 Stat. 119, 173 (2010).

⁶⁰ *Id.* § 1311(d)(1) (“An Exchange shall be a governmental agency or nonprofit entity that is established by a State.”).

⁶¹ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1304 (d), 124 Stat. 119, 172 (2010). But note that Section 1323 provides: “A territory that elects...to establish an Exchange in accordance with part II of this subtitle and establishes such an Exchange in accordance with such part shall be treated as a State for purposes of such part[.]” Health Care and Education Reconciliation Act, Pub. L. No. 111-152, Sec. 1204, 124 Stat. 1029, 1055-1056 (2010).

⁶² *Id.*, § 1321.

⁶³ *Id.*, §1401.

companies.⁶⁴ Section 1402 also authorizes “cost-sharing” subsidies for the purchase of health insurance plans on exchanges designed to help lower-income households obtain more comprehensive coverage through the state-run exchanges.⁶⁵ Section 1402 makes these cost-sharing subsidies, which are direct federal payouts to private health insurance companies, available only where tax credits are available—i.e., through state-run exchanges.⁶⁶

III. The IRS Rule

On August 17, 2011, the IRS proposed a regulation to implement Section 36B that would offer premium assistance tax credits through federal Exchanges. As proposed by the IRS, the rule provided that:

a taxpayer is eligible for the credit for a taxable year if...the taxpayer or a member of the taxpayer’s family (1) is enrolled in one or more qualified health plans through an Exchange established under section 1311 *or* 1321 of the Affordable Care Act...⁶⁷

If the tax credits authorized by Section 1401 are to be available without regard to whether an insurance plan is purchased through a state-run (Section 1311) or federal Exchange (Section 1321), the same will be true for cost-sharing subsidies, which Section 1402 makes available wherever tax credits are available. Since the receipt of tax credits or cost-sharing subsidies by workers triggers tax penalties against employers, another result of the rule is that it taxes

⁶⁴ Nonrefundable credits only reduce a taxpayer’s tax liability. For example, if a taxpayer has a \$5,000 tax liability and is eligible for a \$6,000 non-refundable credit, it will wipe out her tax liability but she will receive only \$5,000 of benefit rather than the full \$6,000 for which she was eligible. If the credit is refundable, however, she receives the full \$6,000 benefit: the credit wipes out her \$5,000 tax liability and the IRS issues her a \$1,000 payment.

⁶⁵ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1402, 124 Stat. 119, 221 (2010).

⁶⁶ *Id.* (“No cost-sharing reduction shall be allowed under this section...unless...a credit is allowed to the insured (or an applicable taxpayer on behalf of the insured) under section 36B of such Code”).

⁶⁷ Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 76 FEDERAL REGISTER 50934 (August 17, 2011) (emphasis added), available at: <http://www.gpo.gov/fdsys/pkg/FR-2011-08-17/pdf/2011-20728.pdf>.

employers who otherwise would be exempt from PPACA’s employer mandate—i.e., employers in states that decline to create an Exchange. And since the availability of tax credits will reduce the “required contributions” of many taxpayers from above 8 percent of household income to below that threshold, another result is that the rule taxes many individuals who would otherwise be exempt from the individual mandate—again, individuals in states that decline to create an Exchange.

The proposed rule did not identify any specific statutory authority for the extension of tax credits and cost-sharing subsidies, or the imposition of the individual and employer mandates on exempt persons, through federal Exchanges. This is understandable, as the plain text of the PPACA does not authorize these actions in federal Exchanges. The rule thus amends the tax code by offering tax credits not authorized by the statute, and by taxing individuals and employers whom the statute does not authorize the IRS to tax.

Indeed, tax reduction is only a minor part of the rule’s impact. On balance, it is a large tax increase. Since the tax credits are “refundable” (i.e., individuals with no tax liability receive a cash payout from the IRS) and the cost-sharing subsidies are federal payments that flow directly to private health insurance companies, the rule also appropriates federal dollars without statutory authority. Those expenditures completely swamp any tax reduction. Official projections show 78 percent of the budgetary impact of the tax credits and cost-sharing subsidies is new spending, with tax reduction accounting for just 22 percent.⁶⁸ Net of revenue from the employer-mandate penalties that those tax credits will trigger, new spending accounts for roughly 90 percent of the

⁶⁸ Letter from Douglas W. Elmendorf, Director, Congressional Budget Office, to John Boehner, Speaker of the House, Direct Spending and Revenue Effects of H.R. 6079, the Repeal of Obamacare Act, as Passed by the House of Representatives on July 11, 2012 (July 24, 2012), *available at*: <http://www.cbo.gov/sites/default/files/cbofiles/attachments/43471-hr6079.pdf> and authors’ calculations.

rule’s budgetary impact, and tax reduction just 10 percent.⁶⁹ Since every dollar of government spending must eventually be paid for through taxes, the cost of this new spending will be borne by taxpayers. Roughly speaking, for every \$2 of tax reduction, the rule triggers \$1 in immediate tax increases and \$8 dollars of new deficit spending, the costs of which will be inevitably borne by taxpayers.

The actual cost of the rule cannot be known with certainty, as it depends on how many and which states ultimately decline to create an Exchange and decline to implement the law’s Medicaid expansion. But its cost is certainly larger than a routine IRS rule.⁷⁰ At a minimum, the governors of Florida,⁷¹ New Hampshire,⁷² Louisiana,⁷³ Wisconsin,⁷⁴ South Carolina,⁷⁵ Texas,⁷⁶

⁶⁹ Letter from Douglas W. Elmendorf, Director, Congressional Budget Office, to John Boehner, Speaker of the House, Direct Spending and Revenue Effects of H.R. 6079, the Repeal of Obamacare Act, as Passed by the House of Representatives on July 11, 2012 (July 24, 2012), *available at*: <http://www.cbo.gov/sites/default/files/cbofiles/attachments/43471-hr6079.pdf> and authors’ calculations.

⁷⁰ Curiously, the IRS concluded that the rule would not have a significant economic effect. See Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 77 FEDERAL REGISTER 30378 (May 23, 2012), *available at*: <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf> (“It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required”). Yet by authorizing tax credits in as many as 15 to 30 states without state-run exchanges, the rule clearly exceeds the statutory threshold for significant rules. The rule would seem to qualify as a “significant regulatory action” under EO 12866 and a “major rule” under the Congressional Review Act. *See* Executive Order 12,866 (defining a “significant regulatory action” as a regulation expected to have an annual effect on the economy of \$100 million or more); 5 U.S.C. § 804 (2) (defining major rule as a regulation any rule with an anticipated annual cost or economic effect of \$100 million or more).

⁷¹ *Scott: We Won’t Comply With Medicaid Expansion*, CBS MIAMI, June 30, 2012, <http://miami.cbslocal.com/2012/06/30/scott-we-wont-comply-with-medicaid-expansion/> (Quoting a spokesman for Gov. Rick Scott (R): “Florida is not going to implement Obamacare. We are not going to expand Medicaid and we’re not going to implement exchanges.”).

⁷² Matthew Spolar, *Lynch Signs Bill Prohibiting State Health Exchange*, CONCORD MONITOR, June 22, 2012, <http://www.concordmonitor.com/article/337540/lynch-signs-bill-prohibiting-state-health-exchange?SESSefad2452e208c288985b42a449cd73d8=google>.

⁷³ Reid Epstein, *GOP Governors Aim for Health Showdown*, POLITICO, June 29, 2012, <http://www.politico.com/news/stories/0612/78024.html> (“Here in Louisiana, look, we refused to set up the exchange. We’re not going to start implementing Obamacare,” Jindal said. “We have not applied for the grants, we have not accepted many of these dollars, we are not implementing the exchanges, we don’t think it makes any sense to implement Obamacare in Louisiana.”).

⁷⁴ *Governors React Nationwide to High Court Ruling*, STATELINE, June 28, 2012, <http://www.pewstates.org/projects/stateline/headlines/governors-react-nationwide-to-high-court-health-ruling-85899402014>. (Governor Scott Walker (R): “Wisconsin will not take any action to implement ObamaCare. I am

and Kansas⁷⁷ have announced their states will not establish Exchanges. Estimates by the Urban Institute suggest that had this rule been in effect in 2011, it would have cost more than \$2 billion in Florida alone.⁷⁸ At the other unlikely extreme, if no state created an Exchange, Congressional Budget Office estimates suggest the rule could cost the federal government \$1 trillion or more over the next decade, offset by no more than \$172 billion or more collected from penalties under the individual and employer mandates.⁷⁹ In this scenario, the rule would increase federal deficits by an estimated \$828 billion.

hopeful that political changes in Washington D.C. later this year ultimately end the implementation of this law at the federal level.”).

⁷⁵ Rocky Dohmen, *Haley Announces ‘Obamacare’ Stance on Facebook*, DIGITEL MYRTLE BEACH, July 2, 2012, <http://myrtlebeach.thedigitel.com/politics/haley-announces-obamacare-stance-facebook-36696-0702>. (“South Carolina will NOT expand Medicaid, or participate in any health exchanges. We will not support Pres. Obama’s tax increase or job killing agenda. I WILL do everything I can to get Mitt Romney elected and work to strengthen our Senate so that we can repeal this unAmerican policy aimed at moving our country in the wrong direction.”).

⁷⁶ Letter from Texas Gov. Rick Perry (R) to U.S. Secretary of Health and Human Services Kathleen Sebelius, July 9, 2012, <http://governor.state.tx.us/files/press-office/O-SebeliusKathleen201207090024.pdf>. (“I oppose both the expansion of Medicaid as provided in the Patient Protection and Affordable Care Act and the creation of a so-called ‘state’ insurance exchange, because both represent brazen intrusions into the sovereignty of our state.”).

⁷⁷ AP: *Brownback, insurance chief at odds on health care*, GARDEN CITY TELEGRAM, June 29, 2012, <http://www.gctelegram.com/news/AP-KS-HealthCare-06-29-12>. (“Kansas Gov. Sam Brownback said Thursday he wants to wait until after the presidential election to comply with a key provision of the federal health care overhaul upheld by the U.S. Supreme Court, but the state’s Republican insurance commissioner objected.”).

⁷⁸ MATTHEW BUETTGENS, JOHN HOLAHAN AND CAITLIN CARROLL, *HEALTH REFORM ACROSS THE STATES: INCREASED INSURANCE COVERAGE AND FEDERAL SPENDING ON THE EXCHANGES AND MEDICAID 17 (2011)*, available at: <http://www.urban.org/UploadedPDF/412310-Health-Reform-Across-the-States.pdf>.

⁷⁹ In March 2012, the Congressional Budget Office estimated that “Exchange Subsidies and Related Spending” would cost the federal government \$808 billion in new expenditures and forgone revenues from 2012 through 2022, offset by \$113 billion in employer-mandate penalties and \$54 billion in individual-mandate penalties. CONGRESSIONAL BUDGET OFFICE, *UPDATED ESTIMATES FOR THE INSURANCE COVERAGE PROVISIONS OF THE AFFORDABLE CARE ACT (2012)*, available at: <http://cbo.gov/sites/default/files/cbofiles/attachments/03-13-Coverage%20Estimates.pdf>. Those projections, which assumed the availability of tax credits in all states, provided an upper-bound estimate of the cost of the IRS rule (i.e., in the unlikely scenario that zero states established an Exchange), which we cited in a previous draft of this paper.

The potential cost of the IRS rule subsequently rose as a result of the Supreme Court’s June 2012 ruling that Congress cannot deny existing federal Medicaid grants to states that refuse to implement the PPACA’s Medicaid expansion, and states’ responses to that ruling. If a state opts not to implement the Medicaid expansion, more of its population (specifically, individuals between 100-138 percent of the federal poverty level without an offer of insurance from an employer) becomes eligible for premium-assistance tax credits and cost-sharing subsidies. A number of states have indicated they will not implement the Medicaid expansion, while many are still examining the issue.

After the rule was proposed, commentators and several members of Congress raised concerns about the IRS’ apparent lack of statutory authority.⁸⁰ In response, IRS officials and representatives of both the Treasury and HHS Departments insisted such authority was in the Act, yet cited no specific provisions to that effect.⁸¹ A Treasury Department spokeswoman said the Department is “confident that providing tax credits to all eligible Americans, no matter where they live and whether their state runs the exchange, is consistent with the intent of the law and our ability to interpret and implement it.”⁸²

On November 3, 2011, two dozen members of the House of Representatives wrote IRS commissioner Douglas H. Shulman that the proposed rule “contradicts the explicit statutory language describing individuals’ eligibility for receipt of these tax credits.”⁸³ On November 29, Shulman responded:

In July 2012, the CBO to revised its estimate of the cost of “Exchange Subsidies and Related Spending” to slightly more than \$1 trillion, offset by \$55 billion in individual-mandate penalties and \$117 billion in employer-mandate penalties. *See* CONGRESSIONAL BUDGET OFFICE, UPDATED ESTIMATES FOR THE INSURANCE COVERAGE PROVISIONS OF THE AFFORDABLE CARE ACT (Mar. 2012), *available at*: <http://www.cbo.gov/sites/default/files/cbofiles/attachments/03-13-Coverage%20Estimates.pdf>. The potential cost of the IRS rule will climb higher still if more states refuse to expand their Medicaid programs than the CBO assumed.

⁸⁰ Letter from David P. Roe, Representative, U.S. House of Representatives, to Douglas Shulman, Commissioner, Internal Revenue Service (Nov. 4, 2011), http://roe.house.gov/UploadedFiles/Letter_to_IRS_Commissioner_regarding_tax_credits_under_PPACA_-_11.03.11.pdf; Letter from Orrin G. Hatch, Senator, US Senate, to Timothy Geithner, Secretary, US Treasury and Douglas Shulman, Commissioner, Internal Revenue Service (Dec. 1, 2011), <http://finance.senate.gov/newsroom/ranking/download/?id=d8c3f533-132c-4cec-be10-8008402c21d8>; *see also* Adler and Cannon, *Another ObamaCare Glitch*, *supra*.

⁸¹ *See, e.g.*, Letter from Douglas H. Shulman, Commissioner, Internal Revenue Service, to David P. Roe, Representative, U.S. House of Representatives, Response to Letter Regarding Premium Tax Credits Under PPACA, (Nov. 29, 2011), *available at*: http://roe.house.gov/UploadedFiles/IRS_Response_to_letter_on_PPACA_Exchange.pdf; CENTERS FOR MEDICARE AND MEDICAID SERVICES, CENTER FOR CONSUMER INFORMATION AND INSURANCE OVERSIGHT, STATE EXCHANGE IMPLEMENTATION QUESTIONS AND ANSWERS 8, (November 29, 2011) (emphasis added), *available at*: http://ccio.cms.gov/resources/files/Files2/11282011/exchange_q_and_a.pdf.pdf.

⁸² *See* Sara Hansard, *Private Exchanges Could Impact Success of State Exchanges*, BNA HEALTH INSURANCE REPORT, Oct. 26, 2011.

⁸³ Letter from David P. Roe, Representative, U.S. House of Representatives, to Douglas Shulman, Commissioner, Internal Revenue Service (Nov. 4, 2011), *available at*: http://roe.house.gov/UploadedFiles/Letter_to_IRS_Commissioner_regarding_tax_credits_under_PPACA_-_11.03.11.pdf.

The statute includes *language that indicates* that individuals are eligible for tax credits whether they are enrolled through a State-based Exchange or a Federally-facilitated Exchange. Additionally, neither the Congressional Budget Office score nor the Joint Committee on Taxation technical explanation of the Affordable Care Act discusses excluding those enrolled through a Federally-facilitated Exchange.⁸⁴

Also on November 29, the Department of Health and Human Services offered a similar defense:

The proposed regulations...are clear on this point and *supported by the statute*. Individuals enrolled in coverage through either a State-based Exchange or a Federally-facilitated Exchange may be eligible for tax credits...Additionally, neither the Congressional Budget Office score nor the Joint Committee on Taxation technical explanation discussed limiting the credit to those enrolled through a State-based Exchange.⁸⁵

Neither statement identified any specific statutory provisions in support of the IRS' authority to issue this rule or provide tax credits for non-state-established exchanges.

Despite the public concerns about its lack of authority to levy taxes or offer tax credits beyond those expressly authorized by Congress, the IRS stayed the course. Late in the afternoon on Friday, May 18, 2012,⁸⁶ the IRS issued a final rule adopting its proposal without significant change.⁸⁷

On December 1, Senate Finance Committee ranking member Orrin Hatch (R-UT) likewise pressed this issue in a letter to Shulman and Treasury Secretary Timothy Geithner. Sam Baker, *Hatch: IRS can't offer tax credits in federal insurance exchange*, THE HILL, Dec. 1, 2011, <http://thehill.com/blogs/healthwatch/health-reform-implementation/196585-hatch-irs-cant-offer-tax-credits-in-federal-insurance-exchange>; and Letter from Orrin G. Hatch, Senator, U.S. Senate, to Timothy Geithner, Secretary, Department of the Treasury and Douglas Shulman, Commissioner, Internal Revenue Service (Dec. 1, 2011), *available at*: <http://finance.senate.gov/newsroom/ranking/download/?id=d8c3f533-132c-4cec-be10-8008402c21d8>.

⁸⁴ Letter from Douglas H. Shulman, Commissioner, Internal Revenue Service, to David P. Roe, Representative, U.S. House of Representatives (Nov. 29, 2011), *available at*: http://roe.house.gov/UploadedFiles/IRS_Response_to_letter_on_PPACA_Exchange.pdf (emphasis added).

⁸⁵ CENTERS FOR MEDICARE AND MEDICAID SERVICES, CENTER FOR CONSUMER INFORMATION AND INSURANCE OVERSIGHT, STATE EXCHANGE IMPLEMENTATION QUESTIONS AND ANSWERS 8, (Nov. 29, 2011) (emphasis added), *available at*: http://cciio.cms.gov/resources/files/Files2/11282011/exchange_q_and_a.pdf.pdf.

⁸⁶ *The Art of the Friday News-Dump*, NATIONAL JOURNAL (Aug. 12, 2011), http://www.nationaljournal.com/the-art-of-the-friday-news-dump-20110722#photo_0 (“When newsmakers release a tidbit on a Friday afternoon, chances are, it’s not something that puts them in the best light. Stories dumped on Fridays, as the strategy suggests, peter out during the weekend -- or at least give the subjects more time to craft their responses.”).

⁸⁷ Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 77 FEDERAL REGISTER 30378 (May 23, 2012), *available at*: <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf>

In defense of its rule, the IRS claimed that its authorization of tax credits and premium assistance was supported by legislative intent, if not the actual language of the PPACA.

Specifically, the final IRS rule provided the following justification:

Under the proposed regulations, the term Exchange has the same meaning as in 45 CFR 155.20, which provides that the term Exchange refers to a State Exchange, regional Exchange, subsidiary Exchange, and Federally-facilitated Exchange.

Commentators disagreed on whether the language in section 36B(b)(2)(A) limits the availability of the premium tax credit only to taxpayers who enroll in qualified health plans on State Exchanges.

The statutory language of section 36B and other provisions of the Affordable Care Act *support the interpretation* that credits are available to taxpayers who obtain coverage through a State Exchange, regional Exchange, subsidiary Exchange, and the Federally-facilitated Exchange. Moreover, the *relevant* legislative history *does not demonstrate that Congress intended to limit* the premium tax credit to State Exchanges. Accordingly, the final regulations maintain the rule in the proposed regulations because it is *consistent with the language, purpose, and structure of section 36B and the Affordable Care Act as a whole*.⁸⁸

Nowhere did the IRS claim that the language of section 36B makes tax credits available in federal Exchanges established under Section 1321, nor that the PPACA authorizes the IRS to extend tax credits to federal Exchanges, nor did the IRS claim that its interpretation is compelled by the text of the PPACA. Rather, the IRS claimed that various unidentified provisions of the law “support” its interpretation, that its rule is “consistent with” the Act, and that the “*relevant legislative history*” does not show otherwise.

The IRS’s decision to offer tax credits in federal Exchanges, and its rationale for that decision, are departures from the agency’s strict adherence to the plain meaning of the statute concerning far less consequential matters.⁸⁹ That rationale is not a particularly compelling basis

(“Accordingly, the final regulations maintain the rule in the proposed regulations because it is consistent with the language, purpose, and structure of section 36B and the Affordable Care Act as a whole”).

⁸⁸ *Id.* (emphases added).

⁸⁹ Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 77 FEDERAL REGISTER 30378 (May 23, 2012), available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf>

upon which to levy new taxes and issue new entitlements not authorized by Congress. When considered in light of the PPACA’s statutory text, structure, purpose and history, the justification offered by the IRS is particularly wanting.

IV. Text, Structure, and Congressional Intent

(“Commentators requested that the final regulations treat a taxpayer whose household income exceeds 400 percent of the FPL for the taxpayer’s family size as an applicable taxpayer if, at enrollment, the Exchange estimates that the taxpayer’s household income will be between 100 and 400 percent of the FPL for the taxpayer’s family size and approves advance credit payments. Other commentators advocated allowing taxpayers with household income above 400 percent of the FPL for their family size to be treated as eligible for a premium tax credit for the months before a change in circumstances affecting household income occurs or for the months for which the taxpayer receives advance payments. The final regulations do not adopt these comments because they are contrary to the language of section 36B limiting the premium tax credit to taxpayers with household income for the taxable year at or below 400 percent of the FPL for the taxpayer’s family size.”); Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 77 FEDERAL REGISTER 30378 (May 23, 2012), available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf> (“Commentators requested that the final regulations allow an individual who may be claimed as a dependent by another taxpayer to qualify as an applicable taxpayer for a taxable year if, for the taxable year, another taxpayer does not claim the individual as a dependent. The final regulations do not adopt this comment because it is inconsistent with section 36B(c)(1)(D), which provides that a premium tax credit is not allowed to any individual for whom a deduction under section 151 is “allowable to another taxpayer” for the taxable year.”); Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 77 FEDERAL REGISTER 30379 (May 23, 2012), available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf> (“Commentators requested that the final regulations define eligibility for government-sponsored programs as actual enrollment for individuals suffering from end stage renal disease who become eligible for Medicare as a result of their diagnosis. Other commentators requested this treatment for any individual suffering from an acute illness who becomes eligible for a government-sponsored program. . . . Section 36B(c)(2)(B) establishes a clear structure under which eligibility for government-sponsored minimum essential coverage in a given month precludes including an individual in a taxpayer’s coverage family for purposes of computing the premium assistance amount for that month. In keeping with the statutory scheme, the final regulations do not adopt these comments.”); Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 77 FEDERAL REGISTER 30384 (May 23, 2012), available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf> (“Commentators suggested that the final regulations adopt a safe harbor for individuals and families who can demonstrate that they accurately reported any changes in income or family size to the Exchange and that their advance payments were properly computed based on the information available at the time the payments were made. Commentators suggested that taxpayers who experience changes in circumstances during the year, including taxpayers whose household income for the taxable year exceeds 400 percent of the FPL, should be allowed to prorate the repayment limitations based on the portion of the year the taxpayer receives advance payments. Other commentators asked that taxpayers who would experience a hardship as a result of repaying excess advance payments be exempt from the repayment requirement or that the IRS should disregard changes that cause income to slightly exceed 400 percent of the FPL. Commentators also suggested that taxpayers be allowed to compute their premium tax credit using the largest family size of the household during the year rather than the family size reported on the tax return. The statute sets forth clear rules for reconciling advance credit payments, which are not consistent with the suggestions made by the commentators. Accordingly, the final regulations do not adopt these comments.”).

The IRS rule is illegal. It is not authorized by the text of the PPACA, nor can it be justified on other grounds. Neither the structure of the statute, its legislative history, nor other indicia of congressional intent support the IRS position.⁹⁰ Section 1401’s language restricting tax credits to states that establish an Exchange under section 1311 is clear and unambiguous. Its inclusion was intentional and purposeful. The remainder of the statute, along with the Act’s legislative history, shows that the plain meaning of Section 1401 reflects Congress’ intent. The PPACA’s authors strongly preferred state-run Exchanges over federal Exchanges. The statute repeatedly uses financial incentives to encourage states and others to comply with the Act’s regulatory scheme. Both of the PPACA’s antecedent bills contained the same feature of withholding subsidies from residents of uncooperative states. During congressional consideration, the PPACA’s lead author affirmed that a state must establish an Exchange for tax credits to become available. The PPACA’s authors knew how to provide that Exchanges established by different levels of government should operate similarly, and they did so through the HCERA when that was their intent. Similarly, they knew how to authorize tax credits in Exchanges established by levels of government other than the states, which they also did through HCERA. While PPACA supporters in the House and Senate closely scrutinized and repeatedly amended Section 1401 through the HCERA, they left intact the provisions restricting eligibility for tax credits to taxpayers purchasing coverage through state-run Exchanges. Finally, even if all

⁹⁰ Although this article often refers to congressional “intent,” a body composed of 535 individuals cannot be said to have a single “intent.” This is a convenient “shorthand” for how to characterize what is actually the result of negotiation, compromise, and deal-making among many lawmakers, each of whom may have his or her own specific intent with regard to the legislation. See Matthew C. Stephenson, *The Price of Public Action: Constitutional Doctrine and the Judicial Manipulation of Legislative Enactment Costs*, 118 YALE L.J. 2, 13 n.25 (2008) (“Characterizing the legislature, or the enacting coalition, as a unitary actor that ‘knows’ the effect of policies on outcomes and chooses the policy that would advance ‘its’ interest is a shorthand way of describing this more complex collective choice process.”). Thus to say that a bill provision was intentional is to say that it is a result of this process, and was drafted as intended by some of those involved in writing and amending the bill, and not to claim that every member of Congress who supported a bill desired each provision of the bill. This is particularly so given the unfortunate tendency of some legislators to not even read the legislation upon which they express opinions and cast votes. See generally, Hanah Volokh, *A Read-the-Bill Rule for Congress*, 76 MO. L. REV. 135 (2011).

of the foregoing evidence demonstrating that section 1401 accurately reflects congressional intent did not exist, PPACA supporters’ actions reveal that their intent was indeed to enact a bill that restricts tax credits to state-run Exchanges. Professor Timothy Jost argues the provisions restricting tax credits to state-run Exchanges “clearly say what Congress clearly did not mean.”⁹¹ The reality is that the statute clearly says what its authors meant.

A. Plain Text

The starting point for statutory interpretation is the statutory text.⁹² As noted above, the PPACA authorizes two methods for establishing a health insurance Exchange within a state. Section 1311 provides that “Each State shall, not later than January 1, 2014, establish an American Health Benefit Exchange (referred to in this title as an ‘Exchange’)” and lays out rules for state-run Exchanges.⁹³ In particular, for purposes of Section 1311, the Act requires that an Exchange must be “a governmental agency or nonprofit entity that is established by a State.”⁹⁴

Section 1321 requires the federal government to create an Exchange in states that elect not to create one of their own. Specifically, Section 1321 requires the HHS Secretary to “establish and operate” an Exchange within any state that either fails to create an Exchange or fails to implement the PPACA’s health insurance regulations to the Secretary’s satisfaction.

⁹¹ Timothy S. Jost, *Yes, the Federal Exchange Can Offer Premium Tax Credits*, HEALTH REFORM WATCH, Sept. 11, 2011, <http://www.healthreformwatch.com/2011/09/11/yes-the-federal-exchange-can-offer-premium-tax-credits/>. Cf. *Conn. Nat’l Bank v. Germain*, 503 U.S. 249, 254 (1992) (“courts must presume that a legislature says in a statute what it means and means in a statute what it says there.”).

⁹² *See, e.g.*, *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979) (“the starting point in any case involving the meaning of a statute[] is the language of the statute itself.”); *Caminetti v. United States*, 242 U.S. 470, 485 (1917) (“It is elementary that the meaning of a statute must, in the first instance, be sought in the language in which the act is framed”). *see also*, *Unif. Statute & Rule Construction Act § 19* (1995) (*Primacy of Text*. The text of a statute or rule is the primary, essential source of its meaning.”).

⁹³ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1311, 124 Stat. 119, 173 (2010).

⁹⁴ *Id.* § 1311(d).

Section 1321 thus requires a federal “fallback” for states that do not create Exchanges of their own. State exchanges created under section 1311 and federal fallback exchanges created under Section 1321 are distinct.

Section 1401 authorizes premium-assistance tax credits and makes them available only through state-run Exchanges. This section specifies that taxpayers may receive a tax credit only during a qualifying “coverage month,” and that a coverage month occurs only when “the taxpayer is covered by a qualified health plan...that was enrolled in through an Exchange *established by the State under section 1311* of the Patient Protection and Affordable Care Act.”⁹⁵ Section 1401 further emphasizes that tax credits are available only through Section 1311 Exchanges when it details the two methods for calculating the amount of the tax credit for which an individual is eligible. The first method bases the amount on the premiums of a qualified health plan that the taxpayer “enrolled in through an Exchange *established by the State under [section] 1311* of the Patient Protection and Affordable Care Act.”⁹⁶ The second method bases the amount on the premium of the “second lowest cost silver plan...which is offered *through the same Exchange* through which the qualified health plans taken into account under [the first method] were offered.”⁹⁷ Both methods therefore require that a taxpayer obtain coverage through a state-run Exchange. The second method also relies on the concept of an “adjusted monthly premium,” which only applies to “individual[s] covered under a qualified health plan taken into account under paragraph (2)(A)”⁹⁸—i.e., “through an Exchange established by the State under [section] 1311.”⁹⁹

⁹⁵ *Id.* (emphasis added).

⁹⁶ *Id.* § 1401 (emphasis added).

⁹⁷ *Id.* (emphasis added).

⁹⁸ *Id.*

⁹⁹ *Id.*

These clauses either employ or refer to not one but two limiting phrases: “by the State” and “under section 1311.” Either phrase by itself would have been sufficient to limit availability of tax credits to state-run Exchanges, since states can only establish Exchanges under section 1311 and section 1311 provides no authority for any other entity to establish Exchanges. The use of both phrases makes the meaning and effect of the language abundantly clear. The Act goes to great lengths to restrict tax credits to state-run Exchanges, and contains no parallel language authorizing tax credits in Exchanges established by the federal government under section 1321.

As the Congressional Research Service has written:

[A] strictly textual analysis of the plain meaning of the provision would likely lead to the conclusion that the IRS’s authority to issue the premium tax credits is limited only to situations in which the taxpayer is enrolled in a state-established exchange. Therefore, an IRS interpretation that extended tax credits to those enrolled in federally facilitated exchanges would be contrary to clear congressional intent, receive no *Chevron* deference, and likely be deemed invalid.¹⁰⁰

Section 1402 authorizes cost-sharing subsidies for “an individual who enrolls in a qualified health plan...offered through *an* Exchange.”¹⁰¹ This language would appear more inclusive. But section 1402 also stipulates, “No cost-sharing reduction shall be allowed under this section with respect to coverage for any month unless the month is a coverage month with respect to which a [premium assistance tax] credit is allowed to the insured[.]”¹⁰² In other words, Section 1402 explicitly and exclusively ties cost-sharing subsidies to premium-assistance tax

¹⁰⁰ Memorandum from Jennifer Staman and Todd Garvey, Congressional Research Service, on the Legal Analysis of Availability of Premium Tax Credits in State and Federally Created Exchanges Pursuant to the Affordable Care Act” (July 23, 2012), *available at*: http://www.statereforum.org/sites/default/files/premium_credits_and_federally_created_exchanges_copy.pdf. But note the CRS qualified that conclusion: “However, given the...alternative interpretive arguments that may suggest a more inclusive construction—including legislative history, legislative purpose, and context—a more searching analysis of Congress’s intent in enacting the provision may lead to a less clear result.” We discuss those alternative arguments below.

¹⁰¹ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1402, 124 Stat. 119, 221 (2010) (emphasis added).

¹⁰² *Id.*

credits, which Section 1401 explicitly and exclusively ties to state-run Exchanges created under Section 1311. The statute provides no authority for the IRS to offer either entitlement through federal Exchanges created under Section 1321. Since cost-sharing subsidies are available only where premium-assistance tax credits are available, the remaining discussion will focus primarily on tax credits.

B. Preference for State-Run Exchanges

The language, structure, legislative history, and congressional debate over the PPACA demonstrate that its authors preferred state-run Exchanges to federal Exchanges. From the outset, the Act directs states to establish Exchanges and many PPACA’s supporters presumed that all states would create exchanges of their own. While the Act authorizes the federal government to establish Exchanges for states that fail to comply with the PPACA’s direction, these exchanges are intended to serve as a fallback, and were not intended to replace state-run exchanges.

The text of the PPACA suggests that Congress sought universal state cooperation. Section 1311(b) provides that “each state shall . . . establish an American Health Benefit Exchange” by 2014.¹⁰³ The Act further details various requirements state-run Exchanges must meet. As noted above, the federal government cannot actually force states to create Exchanges, as this would constitute unconstitutional commandeering.¹⁰⁴ The federal government can, however, utilize a combination of positive and negative incentives to induce state cooperation – in this case, subsidies for creating Exchanges and the threat of a federally run Exchange if a state does not create one on its own. Such incentives are common. Various federal programs,

¹⁰³ *Id.* § 1311(b).

¹⁰⁴ *See infra*

including Medicaid, condition the receipt of federal funding on state acceptance of the federal government’s conditions.¹⁰⁵ In this context, limiting the availability of tax credits to insurance purchased in state-run Exchanges can be seen as just one more inducement for state cooperation: the PPACA threatens states with the loss of tax credits for state residents if they do not create an Exchange.

The legislative history shows the Senate Finance Committee, where PPACA originated, wrestled with the question of whether states or the federal government should take the lead in creating exchanges and that advocates of state-run exchanges prevailed. A November 2008 “white paper” issued by chairman Max Baucus (D-MT) endorsed a single, federal exchange: “The Baucus plan would ensure that every individual can access affordable coverage by creating a nationwide insurance pool called the Health Insurance Exchange.”¹⁰⁶ The committee subsequently heard testimony from a broad coalition endorsing state-run rather than federal exchanges.¹⁰⁷ When Sen. Baucus introduced his “chairman’s mark” in September 2009, it

¹⁰⁵ Additional examples include the No Child Left Behind Act, the Safe Drinking Water Act, and the Clean Air Act.

¹⁰⁶ MAX BAUCUS, REFORMING AMERICA’S HEALTH CARE SYSTEM: A CALL TO ACTION iv (Nov. 12, 2008), available at: <http://finance.senate.gov/download/?id=916b0ea3-96dc-4c7a-bb35-241fa822367e>.

¹⁰⁷ See *Roundtable Discussion on Expanding Health Care Coverage, Before the S. Comm on Finance*, 111th Cong., (May 5, 2009) (Testimony of Stuart M. Butler), available at: <http://www.finance.senate.gov/imo/media/doc/Stuart%20Butler.pdf>:

There is broad support for the concept of a health insurance exchange to improve the functioning of a competitive market for plans...But should an exchange be at the national level, or at the state level, and should there be overlapping exchanges? A national exchange may seem attractive but it is accompanied by many problems...The solution would be for the federal government to do two things. First, set out broad objectives for exchanges, and allow states to propose designs for state or regional exchanges to be certified by the federal government.

Roundtable Discussion on Expanding Health Care Coverage, Before the S. Comm on Finance, 111th Cong., (May 5, 2009) (Testimony of Len M. Nichols), available at: <http://www.finance.senate.gov/imo/media/doc/Len%20Nichols.pdf>:

Do note, however, these new exchanges could be organized at the state or even substate levels. It is not necessary (or wise) to have one national exchange/marketplace...Insurance market rules governing the new marketplaces should be uniform across the country, but the exchanges themselves could be organized on a national, state, or sub-state level. It is important to remember that all health markets (like politics) are

directed states to establish exchanges and provided for a federal fallback exchange.¹⁰⁸ Advocates of state-established exchanges prevailed in the Finance Committee and later in both chambers of Congress.

The congressional debate emphasized state-run Exchanges over federal Exchanges. We surveyed eight Senate committee hearings and markups,¹⁰⁹ the Finance Committee chairman’s mark of the America’s Healthy Future Act of 2009¹¹⁰, and the House and Senate floor debates over the PPACA.¹¹¹ In those venues, Democratic members of Congress and their staffs made 117 references to “state Exchanges” or state-established Exchanges, three references to federal

local. Competing against Kaiser in San Francisco or Group Health in Seattle is different than competing against Blue Cross of Arkansas in Little Rock. Exchange managers and oversight boards can and should bring local expertise and flexibility to the overall federal superstructure.

Roundtable Discussion on Expanding Health Care Coverage, Before the S. Comm on Finance, 111th Cong., (May 5, 2009) (Testimony Of Scott Serota), available at:
<http://www.finance.senate.gov/imo/media/doc/Scott%20Serota.pdf>:

[C]reating a federal ‘connector’ would be complex, costly and time-consuming. Creation of a federal connector could also undermine state regulation and authority, creating conflicting federal-state rules that would result in regulatory confusion and adverse selection. A state-based approach would accomplish the goals of a federal connector while ensuring current consumer protections afforded by state oversight and assuring faster implementation at lower costs by avoiding the creation of a new federal bureaucracy. To encourage states to establish State Insurance Marts, federal funding should be provided to offset the cost of development.

¹⁰⁸ *Chairman’s Mark: America’s Healthy Future Act of 2009, Scheduled for Markup By the Senate Committee on Finance On September 22, 2009*, p. 11, <http://finance.senate.gov/download/?id=a2b7dd18-544f-4798-917e-2b1251f92abb>. (“States must establish an exchange that complies with the requirements set forth in the Federal law. If a state does not establish an exchange within 24 months of enactment, the Secretary of HHS shall contract with a non-governmental entity to establish a state exchange that complies with the Federal legislation.”).

¹⁰⁹ *Full Committee Hearing - Healthcare Reform: Before Senate Comm. on Health, Education, Labor, & Pensions, 111th Cong. (2009)*; *What Women Want: Equal Benefits for Equal Premiums: Full Comm. Hearing Before Senate Comm. on Health, Education, Labor, & Pensions, 111 Cong. (2009)*; *Affordable Health Choices Act: Executive Session Before Senate Comm. on Health, Education, Labor, & Pensions; 111th Cong. (2009)*; *Open Executive Session to Consider an Original Bill Providing for Health Care Reform: Hearing Before Senate Comm. on Finance, 111th Cong. (2009)*; *Covering the Uninsured: Making Health Insurance Markets Work: Hearing Before the Senate Comm. on Finance, 110th Cong. (2008)*; *Finance Committee Field Hearing at St. Patrick Hospital in Missoula, MT: High Health Care Costs: A State Perspective: Before the Senate Comm. on Finance, 110th Cong. (2008)*; *Health Care Reform: An Economic Perspective: Before the Senate Comm. on Finance, 110th Cong. (2008)*; and *The President’s Fiscal Year 2010 Health Care Proposals: Before the Senate Comm. on Finance, 111th Cong. (2009)*.

¹¹⁰ SENATE COMMITTEE ON FINANCE, CHAIRMAN’S MARK, AMERICA’S HEALTHY FUTURE ACT OF 2009 (2009).

¹¹¹ We searched the *Congressional Record* during the periods that each chamber was considering the PPACA: the Senate Record between June 1, 2009 and March 30, 2010, and the House Record between January 19, 2010 and March 22, 2010.

Exchanges, and 359 non-specific references to Exchanges. Republican members of Congress, all of whom opposed PPACA, mentioned state or state-established Exchanges 41 times and federal Exchanges seven times in these venues. The emphasis on state-run Exchanges reflects PPACA’s emphasis. When Republicans spoke of federal Exchanges, it was typically to raise the specter of a federal takeover of health care—a specter that PPACA supporters downplayed by emphasizing that exchanges would be created and run by the states.¹¹² Further reflecting the Act’s preference for state-run Exchanges, the Joint Committee on Taxation’s technical explanation of the revenue provisions in PPACA and HCERA made 15 references to state Exchanges, 0 references to federal Exchanges, and 51 non-specific Exchange references.¹¹³

The PPACA’s authors so heavily favored state-run Exchanges that they created large financial incentives to encourage states to establish them. For example, the Act authorizes the Secretary of Health and Human Services to provide unlimited funding for states to cover the start-up costs of establishing Exchanges.¹¹⁴ As of July 2012, the Secretary had issued a total of \$1.007 billion in Exchange grants to states.¹¹⁵ The Secretary has since announced these grants

¹¹² See, e.g., Senate Democratic Policy Committee, *Fact Check: Responding to Opponents of Health Insurance Reform*, Sept. 21, 2009, available at: <http://dpc.senate.gov/reform/reform-factcheck-092109.pdf> (“There is no government takeover or control of health care in any [S]enate health insurance reform legislation...All the health insurance exchanges, which will create choice and competition for Americans’ business in health care, are run by states.”).

¹¹³ JOINT COMM. ON TAXATION, TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF THE “RECONCILIATION ACT OF 2010,” AS AMENDED, IN COMBINATION WITH THE “PATIENT PROTECTION AND ACCORDABLE CARE ACT (March 21, 2010).

¹¹⁴ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1311, 124 Stat. 119, 177-178 (2010). See especially Memorandum from the Congressional Research Service, on Federal Grants For Planning and Establishment of Health Insurance Exchanges Under Section 1311(a) of the Patient Protection and Affordable Care Act (Feb. 7, 2011).

¹¹⁵ Kaiser Family Foundation, State Health Facts, *Total Health Insurance Exchange Grants, 2012*, (July 26, 2012), <http://statehealthfacts.kff.org/comparabletable.jsp?ind=964&cat=17> (\$1,007,493,875 has been awarded as of July 26, 2012).

will be able to pay “start-up” costs through 2019.¹¹⁶ In contrast, PPACA’s authors failed to authorize any funding for HHS to create federal Exchanges.¹¹⁷ These features—unlimited start-up grants, and a lack of funding for federal Exchanges—appear not only in PPACA, but also in both antecedent bills reported by the Finance and HELP committees.¹¹⁸

C. Financial Incentives

Making credits and subsidies available solely through state-run Exchanges is consistent with the PPACA’s *modus operandi* of using financial incentives to elicit a desired behavior. Under the Act, individuals who fail to obtain health insurance must pay a penalty. Large employers that fail to offer required health benefits likewise must pay a penalty. Under the Act as passed, states that failed to expand their Medicaid programs to everyone below 138 percent of the federal poverty level would have lost all federal Medicaid grants, which account for 12 percent of state revenues.¹¹⁹ States that opt to establish an Exchange may receive unlimited start-

¹¹⁶ See Michael F. Cannon, *HHS Offers to Pay Six Years of Operating Costs for Some States’ Obamacare Exchanges*, CATO@LIBERTY, July 3, 2012, <http://www.cato-at-liberty.org/hhs-offers-to-pay-six-years-of-operating-costs-for-some-states-obamacare-exchanges/>.

¹¹⁷ Michael F. Cannon, *President’s Budget Shows Feds Can’t Create ObamaCare ‘Exchanges’*, CATO@LIBERTY, Feb. 13, 2012, <http://www.cato-at-liberty.org/presidents-budget-shows-feds-cant-create-obamacare-exchanges/>; J. Lester Feder, *Sebelius: Exchange funding request was anticipated*, POLITICO PRO, Feb. 14, 2012, <https://www.politicopro.com/go/?id=9220> [subscription only].

¹¹⁸ The America’s Healthy Future Act of 2009 (S. 1796), section 2237(c). Affordable Health Choices Act, S. 1697, 111th Cong. Sec. 3101(a), pp. 53-56, (2009).

¹¹⁹ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 2001, 124 Stat. 119, 271-275 (2010) as amended by the Health Care and Education Reconciliation Act of 2010. Even after the Supreme Court’s ruling in *NFIB v. Sebelius* invalidating this requirement, the Act conditions new federal Medicaid grants on states expanding their Medicaid programs. CINDY MANN, JOAN C. ALKER, AND DAVID BARISH, *MEDICAID AND STATE BUDGETS: LOOKING AT THE FACTS 6* (May 2008), available at: <http://ccf.georgetown.edu/index/cms-filesystem-action?file=ccf+publications%2Fabout+medicaid%2Fnasbo+final+5-1-08.pdf> (“It is often reported that states spend, on average, almost 22 percent of their state budgets on Medicaid, but this figure can be misleading because it

up funds from the Secretary of Health and Human Services—if, “as determined by the Secretary,” a state makes adequate progress toward establishing an Exchange, implements other parts of the Act, and “meet[s] such other benchmarks as the Secretary may establish.”¹²⁰ This feature—conditioning the continued availability of start-up funds on state cooperation—appears in the HELP committee bill as well.¹²¹ It is scarcely a departure for the Act to condition the availability of tax credits and cost-sharing subsidies on state cooperation.

The language in sections 1401 and 1402 restricting tax credits and cost-sharing subsidies to section 1311 is more than just consistent with the rest of the Act. It is integral to section 1311’s directive that states “shall” create an Exchange. The withholding of tax credits and subsidies in federal Exchanges is the primary sanction imposed on states that do not establish Exchanges themselves.¹²² That restriction thus animates Section 1311’s “shall.” To ignore it would render that directive meaningless.

Many statutes seek to encourage state cooperation by threatening to cut off funding to recalcitrant states.¹²³ The PPACA contains this feature in other provisions, such as the Medicaid

considers federal as well as state funds. On average, federal funds account for 56.2 percent of all Medicaid spending.”)

¹²⁰ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1311, 124 Stat. 119, 173 (2010). . .

¹²¹ The Finance Committee bill contained language almost identical to PPACA. The HELP Committee bill explicitly withheld credits from residents of states that refused or were slow to create their own health insurance Gateways. Choices Act, S. 1697, 111th Cong. Sec. 3104(d), pp. 106-107, (2009).

¹²² The PPACA’s “maintenance of effort” provision requires states to maintain aspects of their Medicaid programs as they were in 2010, which can be a costly proposition, and only lifts this requirement once “the Secretary determines that an Exchange established by the State under section 1311 of the Patient Protection and Affordable Care Act is fully operational.” See 42 U.S.C. § 1396a(a)(74) and § 1396a(gg). There are real questions about whether the maintenance-of-effort provisions are enforceable under *NFIB v. Sebelius*, in which the Supreme Court held that Congress may not impose retroactive conditions on federal Medicaid funds or condition those funds on state participation in a new program. See, e.g., Ralph Lindeman, *ACA Opponents Eyeing New Challenge To Law's Maintenance-of-Effort Requirement*, BNA HEALTH CARE DAILY REPORT, Oct. 26, 2012..

¹²³ Examples range from the Clean Air Act to the No Child Left Behind Act, to the Children’s Internet Protection Act. See generally J. Lester Feder & Darren Samuelsohn, *The Medicaid Ruling’s Ripple Effect*, POLITICO, July 3, 2012, <http://www.politico.com/news/stories/0712/78091.html> (identifying various conditional spending statutes).

expansion.¹²⁴ The Act does not seek to induce state cooperation with the exchange provisions by withholding funding for the Exchanges, however, because it only authorizes funding to help states with their start-up costs. Once the exchanges are established, the states must finance their administration on their own. Thus, the primary financial incentive in the PPACA is the threat of withholding tax credits and subsidies for those states that fail to create exchanges in accord with federal requirements.

D. Antecedent Bills

The PPACA’s antecedent bills, which were reported by the Senate’s Finance Committee and HELP Committee, and which Senate Democrats merged into the PPACA,¹²⁵ further show the plain meaning of Section 1401 accurately reflects Congress’ intent to restrict tax credits to state-run Exchanges. Each of those bills withheld subsidies from taxpayers whose state governments failed to establish an Exchange or otherwise failed to implement the law in accord with federal dictates.

The PPACA’s closest antecedent was the Finance Committee-reported “America’s Healthy Future Act of 2009” (S. 1796),¹²⁶ which also withheld tax credits from taxpayers

¹²⁴ Nat’l Fed’n Indep. Bus. v. Sebelius, 567 U.S. ___, __ (2012) (Roberts, C.J.) (“The threatened loss of over 10 percent of a State’s overall budget... is economic dragooning that leaves the States with no real option but to acquiesce in the Medicaid expansion.”), at 40 (Ginsburg, J., concurring) (“Congress is simply requiring States to do what States have long been required to do to receive Medicaid funding: comply with the conditions Congress prescribes for participation.”), at 28 (Scalia, Kennedy, Thomas, Alito, JJ., dissenting) (The ACA does not legally compel the States to participate in the expanded Medicaid program, but the Act authorizes a severe sanction for any State that refuses to go along: termination of all the State’s Medicaid funding.).

¹²⁵ David M. Herszenhorn and Robert Pear, *White House Team Joins Talks on Health Care Bill*, N.Y. TIMES, Oct. 14, 2009, <http://www.nytimes.com/2009/10/15/health/policy/15health.html>.

¹²⁶ U.S Library of Congress: Thomas, *Bill Summary & Status, 111th Congress, S. 1796, All Information*, 2009, <http://thomas.loc.gov/cgi-bin/bdquery/z?d111:SN01796:@@L&summ2=m&>; America’s Healthy Future Act of 2009, S. 1796, 111th Cong. (2009), <http://www.gpo.gov/fdsys/pkg/BILLS-111s1796pcs/pdf/BILLS-111s1796pcs.pdf>.

purchasing coverage through federal Exchanges. The relevant language in PPACA is nearly identical to that of the Finance bill. The four ways Section 1401 confines tax credits to state-run Exchanges appear almost verbatim in the Finance bill, for example.¹²⁷

The HELP bill even more explicitly withheld credits in states that failed to implement the law, and it employed that strategy to encourage state cooperation even if the federal government created the Exchange. If a state sought to establish its own “Gateway” (i.e., Exchange) then the HELP bill provided that “any resident of that State who is an eligible individual shall be eligible for credits”—but only after the Secretary determined that the state had (A) created a qualified Gateway, (B) enacted legislation imposing various health insurance regulations on the state’s individual and small-group markets, and (C) enacted legislation subjecting its state and local governments to the bill’s employer mandate. If a state failed to meet these criteria, its residents would be ineligible for credits.¹²⁸ When an “establishing state” fell out of compliance, the HELP bill went so far as to revoke credits that state residents had already been receiving.¹²⁹

If a state formally requested that HHS establish a Gateway for the state (such states were called “participating states”), the HELP bill authorized the federal government to do so, and

¹²⁷ Like the PPACA, the Finance bill would have created a new section 36B in the Internal Revenue Code that offers two methods for determining the amount of a taxpayer’s premium assistance tax credit. Under the first method, found in 36B(b)(2)(A)(i), the bill bases the credit amount on the premiums for health plans “which were enrolled in through *an Exchange established by the State under subpart B of title XXII of the Social Security Act*,” a clear and exclusive reference to state-run Exchanges. S. 1796, p. 147. Emphasis added. (But note there is no “subpart B” of the proposed title XXII. The parts in that title take capital letters while the subparts take numbers. Since *Part B* of the proposed title XXII directs states to create Exchanges, however, this appears to be an immaterial scrivener’s error.) The second method uses the “adjusted monthly premium” for “the second lowest cost silver plan in the individual market which is offered through *the same Exchange*.” S. 1796, new IRC section 36B.(b)(3)(B)(i), p. 149. Emphasis added. The definition of “adjusted monthly premium” again refers to “qualified health benefits plan taken into account *under paragraph (2)(A)(i)*.” S. 1796, p. 150. Emphasis added. Finally, the bill also ties “coverage months” to state-run Exchanges by defining them as months in which a taxpayer “is covered by a qualified health benefits plan described in *subsection (b)(2)(A)(i)*.” S. 1796, p. 152. Emphasis added.

¹²⁸ See Affordable Health Choices Act, S. 1697, 111th Cong. Sec. 3104(d), p. 104, (2009).

¹²⁹ “If the Secretary determines that a State has failed to maintain compliance with such requirements, the Secretary may revoke the determination,” thereby revoking eligibility for credits. Affordable Health Choices Act, S. 1697, 111th Cong. Sec. 3104, p. 105, (2009).

authorized credits within the federal Gateway. But the bill again withheld those credits if the state failed to satisfy (B) or (C). If state officials opted neither to be an “establishing state” nor a “participating state,” then the HELP bill (again) authorized the federal government to create a Gateway for the state, authorized credits within that federal Gateway, imposed the bill’s health insurance regulations on the state, and deemed the state to be a “participating state.” However, the bill still withheld credits unless state officials complied with (C).¹³⁰

This history demonstrates that restricting tax credits to state-run Exchanges was a deliberate policy choice. The authors of these provisions sought to limit the availability of credits to state-run exchanges. The PPACA, the Finance bill, and the HELP bill all explicitly withheld credits from individuals as a means of encouraging state officials to implement the law. None of the three bills allowed residents of a state to receive credits absent cooperation by state officials. Some PPACA supporters may have preferred to provide tax credits for the purchase of health insurance in federally run exchanges, but other proponents felt otherwise, and it is this latter group that prevailed.

E. Authorial Intent

Statements by one of the PPACA’s primary authors, Senate Finance Committee Chairman Max Baucus (D-MT), provide additional persuasive evidence that the language of section 1401 was no accident. Senator Baucus sought to encourage states to implement the law. During deliberations over the bill that would become PPACA, Baucus explained to a colleague

¹³⁰ Affordable Health Choices Act, S. 1697, 111th Cong. Sec. 3104, p. 107, (2009).

(Sen. John Ensign, R-NV) that the bill conditions the availability of tax credits on each state creating its own Exchange. Specifically, Senator Baucus explained that even though the Finance Committee does not have jurisdiction over health insurance regulation (such jurisdiction belongs to the HELP Committee), the Finance Committee’s bill could direct states to create exchanges or make other changes to their health insurance laws because the bill made those actions a *precondition* for the availability of tax credits, which are clearly within the Finance Committee’s jurisdiction.¹³¹

In addition to the other purposes it served, that restriction provided the jurisdictional hook that allowed the Finance Committee to direct states to create Exchanges and otherwise alter their health insurance laws. If the Finance Committee bill had authorized tax credits in both state-run and federal exchanges, then the directive that each state “shall” create an exchange would not have been tied to something within the committee’s jurisdiction, and the committee would not have had jurisdiction to issue it. The fact that section 1401 provided the Finance Committee with

¹³¹ In this colloquy, excerpted and lightly edited here, Sen. Baucus backs into an admission that his bill conditions tax credits on state officials creating an Exchange.

Senator Ensign: Is this bill, the underlying premise in this bill that...we are making states change their laws, their coverage laws? Aren’t we doing that? And so why would not most of the coverage rules in this bill, underlying bill, be...only in the jurisdiction of the HELP Committee and not in the jurisdiction of this committee?...On certain minimum plans, exchanges. All those coverage things are state laws...How do we have jurisdiction over changing state laws on coverage?...

The Chairman: There are conditions to participate in the Exchange.

Senator Ensign: That is right.

The Chairman: For setting up an Exchange.

Senator Ensign: These would be conditions to participate—

The Chairman: And states—an Exchange is, essentially is tax credits. Taxes are in the jurisdiction of this committee.

Executive Committee Meeting to Consider an Original Bill Providing for Health Care Reform: Before the S. Comm. on Finance, 111th Cong. 326 (2009), available at:

<http://www.finance.senate.gov/hearings/hearing/download/?id=c6a0c668-37d9-4955-861c-50959b0a8392>. We encourage readers to watch the video of the colloquy. *Executive Committee Meeting to Consider an Original Bill Providing for Health Care Reform: Before the S. Comm. on Finance (C-SPAN broadcast Sept. 23, 2009), at 2:53:21, <http://www.c-spanvideo.org/program/289085-4>.*

this jurisdictional hook shows that PPACA’s authors consciously crafted the language restricting tax credits to state-run Exchanges.

It matters not at all that the need for that jurisdictional hook evaporated when the Finance bill cleared that committee, or that other members of Congress may have preferred a different outcome. The relevant text of the statute maintained this restriction. Nor would it be plausible to argue that the IRS rule is justified because congressional intent subsequently changed, because the language did not.¹³²

In our extensive search of the PPACA’s legislative history, this Baucus comment is the *only* instance we found of a member of Congress discussing whether tax credits would be available in federal exchanges, and it flatly contradicts the IRS’s position. Senator Baucus’s own words show both that the plain meaning of Section 1401 accurately reflects congressional intent, and that the IRS rule undermines congressional intent by discouraging states from creating Exchanges.

F. Nonequivalence

Further evidence that the plain meaning of section 1401 reflects congressional intent is that PPACA supporters knew how to craft language ensuring that Exchanges created by different levels of government would operate identically, yet opted not to create such equivalence with respect to the availability of tax credits in state-run versus federal Exchanges.

The House-passed “Affordable Health Care for America Act” (H.R. 3962), for example, created a single federal Health Insurance Exchange for all states, and allowed states to opt out by creating their own Exchange. To ensure that certain aspects of state-run and federal Exchanges

¹³² As noted below, several revisions were made to Section 1401 through the HCERA, yet the language relevant here was not changed. *See infra*.

would operate in an identical manner, H.R. 3962 contained the following language: “any references in this subtitle to the Health Insurance Exchange or to the Commissioner in the area in which the State-based Health Insurance Exchange operates shall be deemed a reference to the State-based Health Insurance Exchange and the head of such Exchange, respectively.”¹³³ The HELP bill also contained equivalence language,¹³⁴ although, as discussed above, it clearly allowed for state and federal Gateways to function differently based on a state’s level of cooperation.

The PPACA contains equivalence language as well. The Act provides that Exchanges established by U.S. territories shall be equivalent to state-run Exchanges. Section 1323, as added by HCERA, provides, “A territory that elects...to establish an Exchange in accordance with part II of this subtitle”—Part II includes section 1311, but not section 1321—“and establishes such an Exchange in accordance with such part shall be treated as a State for purposes of such part[.]”¹³⁵ Section 1323 also explicitly authorizes and appropriates funds for “premium and cost-sharing assistance to residents of the territory obtaining health insurance coverage through the Exchange[.]”¹³⁶ This language shows PPACA supporters knew how to create equivalence between Section 1311 Exchanges and other Exchanges when that was their intent. The HCERA

¹³³ Affordable Health Care for America Act, H.R. 3962, 111th Cong. Sec. 308(e), pp. 208-209, (2009).

¹³⁴ Affordable Health Choices Act, S. 1697, 111th Cong. Sec. 3101(b), p. 56, (2009) (“A Gateway shall be a governmental agency or nonprofit entity that is established by a State, in the case of an establishing State (as described in section 3104); or the Secretary, in the case of a participating State (as described in section 3104).”)

¹³⁵ Health Care and Education Reconciliation Act, Pub. L. No. 111-152, Sec. 1204, 124 Stat. 1029, 1055-1056 (2010).

¹³⁶ *Id.* § 1204 (b), (c).

added such language for exchanges established by federal territories but not for exchanges established by the federal government.¹³⁷

The PPACA contains additional equivalence language in an information-reporting requirement also added by HCERA.¹³⁸ Supporters of the IRS rule point to this language as evidence that Congress sought to make federal and state-run exchanges equivalent for all purposes of the Act.¹³⁹ They argue there would be no reason to require federal Exchanges to report information pertinent to eligibility for tax credits, or the amount of any advance payments

¹³⁷ As a general rule, if Congress adopts particular language in one part of a statute, but omits it in another, it is presumed Congress acted “intentionally and purposely in the disparate inclusion or exclusion.” *See* *Russello v. United States*, 464 U.S. 16, 23 (1983).

¹³⁸ Health Care and Education Reconciliation Act, Pub. L. No. 111-152, Sec. 1004, 124 Stat. 1029, 1035 (2010) and the Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1401, 124 Stat. 119, 219 (2010) (adds Sec. 36B (f) to the Internal Revenue Code). Congress has amended this subsection through subsequent legislation. See Pub. L. No. 112-9, Sec. 4, 125 STAT. 36-37 (2011).

I.R.C § 36B (f), as added to the PPACA by HCERA:

(3) INFORMATION REQUIREMENT.—Each Exchange (or any person carrying out 1 or more responsibilities of an Exchange under section 1311(f)(3) or 1321(c) of the Patient Protection and Affordable Care Act) shall provide the following information to the Secretary and to the taxpayer with respect to any health plan provided through the Exchange:

(A) The level of coverage described in section 1302(d) of the Patient Protection and Affordable Care Act and the period such coverage was in effect.

(B) The total premium for the coverage without regard to the credit under this section or cost-sharing reductions under section 1402 of such Act.

(C) The aggregate amount of any advance payment of such credit or reductions under section 1412 of such Act.

(D) The name, address, and TIN of the primary insured and the name and TIN of each other individual obtaining coverage under the policy.

(E) Any information provided to the Exchange, including any change of circumstances, necessary to determine eligibility for, and the amount of, such credit.

(F) Information necessary to determine whether a taxpayer has received excess advance payments.

(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section, including regulations which provide for—

(1) the coordination of the credit allowed under this section with the program for advance payment of the credit under section 1412 of the Patient Protection and Affordable Care Act, and

(2) the application of subsection (f) where the filing status of the taxpayer for a taxable year is different from such status used for determining the advance payment of the credit

¹³⁹ Timothy S. Jost, *Yes the Federal Exchange Can Offer Premium Tax Credits*, HEALTH REFORM WATCH (Sept. 11, 2011), <http://www.healthreformwatch.com/2011/09/11/yes-the-federal-exchange-can-offer-premium-tax-credits>.

of those tax credits, to individual taxpayers and the Secretary unless Congress intended for tax credits to be available through federal Exchanges. Alternatively, supporters of the IRS’ position maintain that this reporting requirement demonstrates Congress’ intent to provide tax credits in federal Exchanges or, at the very least, introduces sufficient ambiguity to permit the IRS to resolve the claimed ambiguity by offering tax credits in federal Exchanges.¹⁴⁰ Specifically, Professor Jost argues:

Section 1004 of HCERA amended section 36B(f) of the IRC to impose on exchanges established under section 1311...and under section 1321...the obligation to report to the IRS and to the taxpayer information regarding tax credits provided to individuals through the exchange. In this later-adopted legislation amending the earlier-adopted ACA, Congress demonstrated its understanding that federal exchanges would administer premium tax credits.¹⁴¹

This paragraph is the only provision in the statute that draws equivalence between state-run Exchanges (Section 1311) and federal Exchanges (Section 1321), and it does so by expressly referencing both provisions. Yet that equivalence extends only so far as the paragraph’s information-reporting requirement. This requirement, like section 1401’s provisions restricting tax credits to state-run Exchanges, is clear and unambiguous, supports the plain meaning of section 1401, and likewise advances the Act’s goal of encouraging states to create Exchanges. It does not suggest that Congress erred in limiting tax credits and subsidies to the purchase of health insurance in state-run exchanges.

The reporting requirement and straightforward. Both state-run and federal Exchanges must report an array of information pertaining to the purchase of health insurance plans, including the level of coverage purchased, identifying information about the purchaser, the

¹⁴⁰ The claim that the IRS’ interpretation of the Act on this question should receive *Chevron* deference is discussed *infra*.

¹⁴¹ Timothy S. Jost, *Yes, the Federal Exchange Can Offer Premium Tax Credits*, HEALTH REFORM WATCH, Sept. 11, 2011, <http://www.healthreformwatch.com/2011/09/11/yes-the-federal-exchange-can-offer-premium-tax-credits/>.

premium paid, and the amount of any advance payments of tax credits and cost-sharing subsidies. The paragraph refers to “the credit under this section” a total of four times. Since this paragraph resides in Section 36B, which authorizes tax credits solely in Exchanges “established by the state under section 1311,” it plainly requires federal Exchanges to report zero advance payments. This provision, unlike other portions of the bill, also makes express reference to both section 1311 and section 1321, showing that Congress knew to reference both sections where that was their intent.¹⁴²

Contrary to the suggestion of Professor Jost and others, these reporting requirements do not suggest, let alone require, that tax credits must be available in federal exchanges. Imposing these reporting requirements on both federal and state Exchanges serves to ensure a degree of uniformity in the information provided to the federal government. That not every requirement would seem equally applicable to both state and federal exchanges is not anomalous. It is easier for Congress to draft and enact a single set of reporting requirements than to enact two separate provisions.

The plain language of this section provides that state and federal exchanges must provide information about “any” tax credits an individual receives. “Any,” as used here, is conditional. That an exchange is obligated to report “any” advance payments made means that *if* such payments are made they must be reported. It does not suggest, let alone require, that such payments will be made in all entities covered by the provision, any more than this language suggests that all individuals who purchase insurance within exchanges must be eligible for premium assistance.

¹⁴² See *Russello v. United States*, 464 U.S. 16, 23 (1983) (“Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.”).

This plain reading of the text is also consistent with the rest of the statute. As noted above, an obvious purpose consistent with the Act’s preference for state-run Exchanges: to encourage state officials to establish them. The reporting requirement enables federal Exchanges and the Secretary to notify individual taxpayers of the tax credits for which they would become eligible if their state were to establish an Exchange, and to publicize to state officials and the media the number of taxpayers who would benefit. The reporting requirement thus advances the PPACA’s goal of encouraging states to establish Exchanges.

The fact that the HCERA’s House and Senate authors made no changes to section 1401’s language restricting tax credits to state-run Exchanges corroborates that the plain meaning of section 1401 accurately reflects congressional intent. The HCERA’s authors scoured Section 1401, amending it seven times (and section 1402 five times) but left the language restricting tax credits to state-run Exchanges undisturbed.¹⁴³ It would be difficult to argue that the HCERA’s authors noticed that state and territorial Exchanges were not equivalent in this respect, but somehow failed to notice that asymmetry between state and federal Exchanges.

The plain meaning of this requirement is thus consistent with the rest of Section 1401 and the overarching goals of the law, as is the directive that the Secretary “shall prescribe such regulations as may be necessary to carry out the provisions of this section.” The PPACA draws absolutely no equivalence between state-run and federal Exchanges when it comes to *offering* tax credits. Indeed, the only time it draws any equivalence between state and federal Exchanges is when it requires the Secretary to inform people of that fact.

It is implausible to argue that the information-reporting requirement added by the HCERA reveals a tacit congressional intent that should allow the IRS to override the clear

¹⁴³ See Health Care and Education Reconciliation Act, Pub. L. No. 111-152, 124 Stat. 1029, 1030-1032, 1034-1035 (2010).

language of the law. Again, this paragraph is the only provision in the statute that draws equivalence between state-run Exchanges (Section 1311) and federal Exchanges (Section 1321). That equivalence extends only so far as that requirement, and it serves the same purpose as the rest of section 1401. Further, as noted above, the HCERA’s creation of Section 1323 (regarding territorial Exchanges) further belies the claim that the information-reporting requirement—also added by the HCERA—somehow implies that Congress intended to make tax credits available in federal Exchanges. The reconciliation process gave Congress the opportunity to authorize tax credits into federal Exchanges, just as it authorized them in territorial Exchanges. If that had been Congress’ intent, then Congress could have done so. Congress knew how to authorize tax credits in non-state Exchanges, as evidenced by the (rejected) House bill, the (rejected) language of the HELP bill, and the HCERA’s language regarding territorial Exchanges. That Congress declined to do so corroborates that the plain meaning of Section 1401 reflects Congress’ intent.

G. Revealed Intent

Even if—contrary to the clear language of the statute, its legislative history, and the clear statement of the statute’s sponsor and principal author—PPACA supporters somehow shared a tacit understanding that tax credits would be available in federal Exchanges, Sen. Scott Brown’s election forced PPACA supporters to reveal their intent to secure a partial victory, with no tax credits in federal Exchanges, if the only alternative was no law at all. It may well be the case that, as Prof. Jost writes, “the Senate Bill was not supposed to be the final law.”¹⁴⁴ Yet enacting the House bill was not an option.

¹⁴⁴ Jost, HEALTH AFFAIRS BLOG, *supra*.

Following Scott Brown’s election, congressional Democrats faced two options. The first was to merge the House- and Senate-passed bills in a manner that made enough changes to secure the support of one Senate Republican, thus enabling proponents to invoke cloture on a conference report. This option was problematic. Not only was there no guarantee that Democrats could peel away one senator from the GOP bloc, but doing so could have moved the conference report far enough to the right that House Democrats might have rejected it. The second option was to have the House pass the PPACA, thus sending the bill directly to the president’s desk, and have the House and Senate make limited amendments to the PPACA through the reconciliation process. Congressional Democrats chose the latter strategy. This was in no small part because, while a “regular order” strategy would have moved the PPACA to the right to appease one or another GOP senator, the “reconciliation” strategy would move it to the left to appease House Democrats.

PPACA supporters made a quite deliberate choice to pass a bill with which none of them were completely satisfied, and to use the reconciliation process to make only limited amendments, because a more satisfactory conference report would have failed. They made a decision that, whatever the PPACA’s remaining shortcomings, passing it with limited amendments was the best they could do under the circumstances.¹⁴⁵ If what they passed was a bill without tax credits in federal Exchanges, then that is *exactly* what they intended.

¹⁴⁵ See Letter from 47 health care scholars to Nancy Pelosi, Speaker of the House, et al., (Jan. 22, 2010), available at: http://graphics8.nytimes.com/images/2010/01/22/health/adopt_senate_bill_final.2.pdf. (“Both houses of Congress have adopted legislation that would provide health coverage to tens of millions of Americans, begin to control health care costs that seriously threaten our economy, and improve the quality of health care for every American. These bills are imperfect. Yet they represent a huge step forward in creating a more humane, effective, and sustainable health care system for every American. We have come further than we have ever come before. Only two steps remain. The House must adopt the Senate bill, and the President must sign it... Some differences between the bills, such as the scope of the tax on high-cost plans and the allocation of premium subsidies, should be repaired through the reconciliation process... The Senate bill accomplishes most of what both houses of Congress set out to do; it would largely realize the goals many Americans across the political spectrum espouse in achieving near universal coverage and real delivery reform.”).

H. An Error of Miscalculation

The statute and the legislative record put defenders of the IRS rule in the awkward position of arguing that it was so obviously Congress’ intent to offer tax credits in federal Exchanges that over the course of almost a year of debate over the PPACA, it never occurred to anyone to express that intent out loud. A better explanation is that the PPACA’s authors miscalculated when they assumed this incentive would lead states to establish Exchanges. Just as President Obama predicted that “by 2014, each state will set up what we’re calling a health insurance exchange,”¹⁴⁶ Secretary of Health and Human Services Kathleen Sebelius proclaimed states were “very eager” to create health insurance exchanges and predicted most would quickly do so.¹⁴⁷ According to Sebelius, the end result would “very much be a State-based program.”¹⁴⁸ If the PPACA’s failure to authorize tax credits in federal Exchanges represents an error at all, it is that miscalculation.

Such a miscalculation would be consistent with the widespread view among supporters that the public would grow to support the law over time,¹⁴⁹ or the view that the challenge brought

¹⁴⁶ Barack Obama, U.S President, Remarks on Health Insurance Reform in Portland, Maine (Apr. 1, 2010), *available at*: <http://www.whitehouse.gov/the-press-office/remarks-president-health-insurance-reform-portland-maine>.

¹⁴⁷ *Departments of Labor, Health and Human Services, Education, and Related Agencies Appropriations for 2011: Hearing Before the H. Comm. on Appropriations*, 111th Cong. 170-171 (Mar. 10, 2010) (Statement of Kathleen Sebelius, Secretary, Department of Health and Human Services), *available at*: <http://www.gpo.gov/fdsys/pkg/CHRG-111hrg58233/pdf/CHRG-111hrg58233.pdf>.

¹⁴⁸ *Id.*

¹⁴⁹ See, for example, Naftali Bendavid, *Reid: Voters Like Health Law If They Understand It*, WASHINGTON WIRE, Aug. 4, 2010, <http://blogs.wsj.com/washwire/2010/08/04/reid-voters-like-health-law-if-they-understand-it/> (Quoting Senate Majority Leader Harry Reid (D): “It’s very obvious that people have a lack of understanding of our health care reform bill... The more people learn about this bill, the more they like it... The trend is turning all over America today... Once you explain what’s in the bill, the American people of course like it.”); See also Susie Madrak, *Gov. Ed Rendell: The More People Learn About the Health Care Bill, the More They Like It*, CROOKS AND LIARS, Mar. 28, 2010, <http://crooksandliars.com/susie-madrak/gov-ed-rendell-more-people-learn-abou> (Quoting

against the law by state attorneys general was so lacking in merit that federal courts should sanction the attorneys general.¹⁵⁰ Having created an enormous incentive for states to establish Exchanges, it likely never occurred to some of the Act’s authors that states would decline. This interpretation also explains why the PPACA authorizes no funding for HHS to create federal Exchanges.¹⁵¹ Its authors did not anticipate that such funds would be necessary.¹⁵²

V. Assessing Other Potential Legal Rationales for the IRS Rule

The IRS maintains that the “language, purpose, and structure” of the PPACA support the extension of the tax credits to federal Exchanges. Yet as demonstrated above, neither the text, purpose, structure, nor history of the PPACA support the IRS rule.

That does not end the arguments in favor of the rule, however. Insofar as the language of the PPACA would seem to bar the IRS rule, commentators have suggested several additional rationales in defense of the administrative extension of tax credits and subsidies to federal

former Pennsylvania Gov. Ed Rendell (D): “As more and more people get to understand what’s in this bill, people are going to like it.”).

¹⁵⁰ See Timothy S. Jost, *Sanction the 18 state AGs*, THE NATIONAL LAW JOURNAL, Apr. 12, 2010, <http://www.law.com/jsp/nlj/legaltimes/PubArticleFriendlyLT.jsp?id=1202447759851&slreturn=1>:

As we all know, Rule 11 of the Federal Rules of Civil Procedure requires an attorney filing a pleading in federal court to certify that “the claims, defenses, and other legal contentions are warranted by existing law” and “the factual contentions have evidentiary support.” The court can sanction an attorney who violates this rule, including an obligation to pay the costs and reasonable attorney fees of the opposing party... This complaint not only represents shockingly shoddy lawyering but should be recognized by the courts for what it in fact is: A pleading whose key claims are without support in the law and the facts. The attorneys who brought this case — solely for political purposes — should have to bear personally the cost of defending this litigation that they are imposing on federal taxpayers.

¹⁵¹ J. Lester Feder, *HHS May Have to Get ‘Creative’ on Exchange*, POLITICO, Aug. 16, 2011, <http://www.politico.com/news/stories/0811/61513.html#ixzz1zaMIZBtO>.

¹⁵² To paraphrase another famous miscalculation, the PPACA’s authors believed that when they reached states capitols, they would be greeted as liberators. See *Anti-war Ad Says Bush, Cheney, Rumsfeld & Rice “Lied” About Iraq*, FACTCHECK, Sept. 25, 2005, http://www.factcheck.org/iraq/print_anti-war_ad_says_bush_cheney_rumsfeld.html (Quoting Vice President Dick Cheney on the eve of the U.S.-led invasion of Iraq: “We will be greeted as liberators.”).

exchanges. First, some suggest that the language of Section 1401 was a “scrivener’s error” that the IRS, and any reviewing court, would be justified in disregarding. Alternatively, some suggest the plain text of Section 1401 should be disregarded because it would produce “absurd results” that undermine the purpose and intent of the PPACA. Third, some argue that, insofar as the text of Section 36B is ambiguous or unclear, particularly when read in light of subsequent amendments, the IRS should receive deference for its interpretation under the *Chevron* doctrine. Finally, some argue that statutes should be read in light of evaluations by Congressional agencies, such as the Congressional Budget Office, and that such an approach would support the IRS rule. Each of these arguments has a superficial plausibility. None withstand scrutiny.

A. Scrivener’s Error

One possible argument in defense of the IRS rule is that the text of the PPACA contains a simple mistake that the IRS can and should disregard. Specifically, the claim is that Section 1401’s failure to reference federal Exchanges created pursuant to the authority in Section 1321 was an error made in the drafting or transcribing of the legislation, and does not reflect legislative intent. Professor Timothy Jost, for instance, has argued that the textual limitation of tax credits and subsidies to state-run (i.e. section 1311) Exchanges is a “drafting error” that “is obvious to anyone who understands” the PPACA.¹⁵³ If the “error” is, in fact, “obvious,” then it

¹⁵³ Timothy S. Jost, *Yes, the Federal Exchange Can Offer Premium Tax Credits*, HEALTH REFORM WATCH, Sept. 11, 2011, <http://www.healthreformwatch.com/2011/09/11/yes-the-federal-exchange-can-offer-premium-tax-credits/>; see also Robert Pear, *Brawling Over Health Care Moves to Rules on Exchanges*, N.Y. TIMES, July 7, 2012 (“Some supporters of the law say Congress may have made a mistake in drafting this section.”). Professor Jost has since abandoned this argument. See Timothy Jost, *Tax Credits in Federally Facilitated Exchanges Are Consistent with the Affordable Care Act’s Language and History*, HEALTH AFFAIRS BLOG, July 18, 2012 (“I agree with Cannon and Adler that the courts are unlikely to find the ‘established by the state’ language a ‘scrivener’s error.’”).

may be the sort of error that a federal agency (and reviewing courts) should disregard as a “scrivener’s error.”¹⁵⁴

A “scrivener’s error” is supposed to be just that – a purely clerical error that could be attributed to a failed transcription or something of that sort.¹⁵⁵ A common example of this sort would be an error in punctuation that, when read literally, alters the meaning of a statutory provision or a mistaken cross-reference to the wrong subsection in a statute – say, mistaking “(i)” for “(ii)” or “Section 36B(B)(I)(b)” for “Section 36(B)(I)(b),” or something of that sort. These are the sorts of mistakes a legislator could easily miss when reviewing 2,000 pages of statutory text or that could even be introduced into a statute when it is amended or transcribed – hence the name “scrivener’s error.”

To establish that a statutory provision is a scrivener’s error typically requires showing that it is *implausible*, not merely unlikely, that a statutory provision was drafted as its authors intended. As the Supreme Court explained in *U.S. National Bank of Oregon v. Independent Insurance Agents of America*, this will only be shown in the “unusual” case in which there is “overwhelming evidence from the structure, language, and subject matter of the law” that Congress could not have consciously adopted the language in the statute.¹⁵⁶ Similarly, in *Appalachian Power Co. v. EPA*, the D.C. Circuit explained that:

¹⁵⁴ See ANTONIN SCALIA & BRYAN A. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 234 (2012) (“No one would contend that the mistake cannot be corrected if it is of the sort sometimes described as a ‘scrivener’s error.’” (citing Daniel A. Farber, *Statutory Interpretation and Legislative Supremacy*, 78 GEO. L.J. 281, 289 (1989) (“If the directive contains a typographical error, correcting the error can hardly be considered disobedience.”)).

¹⁵⁵ In *U.S. National Bank of Oregon v. Indep. Insur. Agents of Amer.*, for example, a “scrivener’s error” – in this case mistaken punctuation that changed the statute’s meaning -- was characterized as “a mistake made by someone unfamiliar with the law’s object and design.” 508 U.S. 439, 462 (1993). According to Justice Antonin Scalia a scrivener’s error may be found “where on the very face of the statute it is clear to the reader that a mistake of expression (rather than of legislative wisdom) has been made.” ANTONIN SCALIA *A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW* 20 (1997). See also Andrew Gold, *Absurd Results, Scrivener’s Errors and Statutory Interpretation*, 75 U. CIN. L. REV. 25, 56-60 (2006).

¹⁵⁶ 508 U.S. 439, 462 (1993).

We will not . . . invoke this rule to ratify an interpretation that abrogates the enacted statutory text absent an extraordinarily convincing justification because . . . the court’s role is not to correct the text so that it better serves the statute’s purposes, for it is the function of the political branches not only to define the goals but also to choose the means for reaching them. . . . Therefore, for the [agency] to avoid a literal interpretation . . . , it must show either that, as a matter of historical fact, Congress did not mean what it appears to have said, or that, as a matter of logic and statutory structure, it almost surely could not have meant it.¹⁵⁷

Further, the showing must be exceedingly strong for a reviewing court to disregard the statute’s text, as the legislature is always free to correct its own mistakes. As Justice Kennedy noted for a unanimous court in *Lamie v. U.S. Trustee*, “If Congress enacted into law something different from what it intended, then it should amend the statute to conform it to its intent.”¹⁵⁸ Where a “scrivener’s error” is found an implementing agency or reviewing court is justified in disregarding the literal text of the statute insofar as this is necessary to correct the mistake, but no farther. The discovery of a scrivener’s error is not a justification for writing a statute anew.¹⁵⁹

Given the PPACA’s unusual (and somewhat hurried) legislative history, one could anticipate that there are scrivener’s errors of one sort or another in the Act. As Justice Stevens observed, “a busy Congress is fully capable of enacting a scrivener’s error into law,”¹⁶⁰ and the Congress that passed the PPACA was extraordinarily busy. Sure enough, some such errors can be found in the Act. For example, there is a textbook scrivener’s error in the very clause where

¹⁵⁷ 249 F.3d 1032 (D.C. Cir. 2001) (internal quotations and citations omitted); *see also* U.S. v. X-Citement Video, 513 U.S. 64, 82 (1994) (Scalia, J., dissenting) (the “sine qua non” of the doctrine “is that the meaning genuinely intended but inadequately expressed must be absolutely clear; otherwise we might be rewriting the statute rather than correcting a technical mistake.”).

¹⁵⁸ 540 U.S. 526, 542 (2004); *see also* U.S. v. Granderson, 511 U.S. 39, 68 (1994) (“It is beyond our province to rescue Congress from its drafting errors and to provide for what we might think . . . the preferred result.”).

¹⁵⁹ As the U.S. Court of Appeals for the D.C. Circuit explained:

Lest it “obtain a license to rewrite the statute,” however, we do not give an agency alleging a scrivener’s error the benefit of *Chevron* step two deference, by which the court credits any reasonable construction of an ambiguous statute. Rather, the agency “may deviate no further from the statute than is needed to protect congressional intent.”

Appalachian Power Co. v. EPA, 249 F.3d 1032, 1043 (D.C. Cir. 2001) (internal citation omitted).

¹⁶⁰ *Koons Buick, Pontiac, GMC, Inc. v. Nigh*, 543 U.S. 50, 65 (2004) (Stevens concurring).

PPACA restricts tax credits to state-run Exchanges. Section 1401 amended the Internal Revenue Code to make taxpayers eligible for premium-assistance tax credits if they enroll in a qualified health plan “through an Exchange established by the State under 1311 of the Patient Protection and Affordable Care Act.”¹⁶¹ Obviously, the authors inadvertently omitted the word “section” before “1311.” The Act contains dozens of references to “section 1311,” including a reference elsewhere in section 1401 that uses identical language but includes the word “section.”¹⁶² The omission of “section” is a clear scrivener’s error. It is an error of transcription, and the language is open to no other interpretation.

Another textbook scrivener’s error exists in the section of PPACA that creates the Independent Payment Advisory Board.¹⁶³ Subsection (f)(1) details the requirements for a type of joint resolution mentioned in “subsection (e)(3)(B).”¹⁶⁴ Yet subsection (e)(3)(B) makes no mention of joint resolutions. The authors clearly meant to refer to subsection (e)(3)(A). It is there that the Act first mentions the joint resolution in question. Subsection (e)(3)(A) even contains a cross-reference: it states that the joint resolution is “described in subsection (f)(1).”¹⁶⁵ The use of “(B)” instead of “(A)” is a textbook scrivener’s error. It is an error of transcription, and is open to no other interpretation.

In contrast to these provisions, the failure to authorize tax credits for insurance purchased through federal exchanges is not a “scrivener’s error.” As noted above, there is ample evidence that the language of the statute provides for what at least some of its authors intended. This is sufficient to defeat a scrivener’s error claim. The alleged error here is also more significant than

¹⁶¹ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1401, 124 Stat. 119, 213 (2010).

¹⁶² *Id.*

¹⁶³ *Id.* § 3403(f)(1); 42 U.S.C. § 1395kkk.

¹⁶⁴ 42 U.S.C. § 1395kkk(f)(1).

¹⁶⁵ 42 U.S.C. § 1395kkk(e)(3)(A)(ii).

the sort typically recognized as a scrivener’s error. Section 1401 specifically references the sort of Exchanges eligible for tax credits (Exchanges “established by the State”) and the relevant section (1311). It makes no mention of federally run Exchanges or Section 1321. A legislator reviewing the relevant language could not claim that they did not realize the statutory cross-reference excluded federal Exchanges because the clear text of the statute does as well.

There is also no evidence we have been able to identify to suggest that the failure to reference Section 1321 in Section 1401 could have been an error of transcription or something of that sort. We have been unable to identify text in any previous iteration of the law—something equivalent to the IRS rule’s “or 1321”—which a legislative staffer or someone else might have mistranscribed or inadvertently dropped in order to produce the result the IRS rule seeks to alter. In every material respect, the final version of the PPACA’s relevant provisions is identical to previous drafts of the Finance Committee bill. However many such errors there may be in the Act, the failure to authorize tax credits for the purchase of health insurance in federally run Exchanges is not among them.

Further, in order to establish the existence of a scrivener’s error that could be corrected by agency regulation, the IRS would have to do more than show that Congress “clearly did not mean”¹⁶⁶ to create a presumably undesirable scenario in which the PPACA’s “community rating” price controls and individual mandate would take effect but the tax credits would not. The IRS would have to meet the more difficult test of showing that Congress *could not* have intended to produce such a result. Supporters of the rule would have to show, as Jost claims, “There is no

¹⁶⁶ Timothy S. Jost, *Yes, the Federal Exchange Can Offer Premium Tax Credits*, HEALTH REFORM WATCH, Sept. 11, 2011, <http://www.healthreformwatch.com/2011/09/11/yes-the-federal-exchange-can-offer-premium-tax-credits/>.

coherent policy reason why Congress would have refused premium tax credits to the citizens of states that ended up with a federal exchange.”¹⁶⁷

The IRS cannot meet this test either. The record clearly shows that PPACA supporters had a coherent policy reason for withholding tax credits from uncooperative states. They considered it a viable means of encouraging states to implement the law. Not only is it plausible that Congress wanted to restrict tax credits to state-run Exchanges, that restriction is an essential part of the Act because it is the primary means of enforcing the directive that states “shall” create Exchanges. The HCERA’s explicit authorization of tax credits and subsidies through territorial Exchanges, and the HELP bill’s explicit authorization of credits through federal Gateways, further imply that PPACA’s authors made a deliberate choice not to include such an authorization in federal Exchanges. The record further shows that PPACA supporters contemplated and even created scenarios like what would exist in federal Exchanges, where community-rating price controls would operate without tax credits or subsidies to mitigate the resulting instability.¹⁶⁸ Such a policy may not be wise or fair. It may even undermine the goal of expanding health insurance coverage to the uninsured. But it is a sufficiently plausible account of Congressional intent to defeat a claim of a scrivener’s error.¹⁶⁹

The feature that the IRS rule seeks to “correct” fails both parts of the scrivener’s-error test. Omitting an entire clause or paragraph authorizing two new entitlements is not an error of transcription. It is not equivalent to omitting the word “section” when referring to Section 1311, nor to mistyping “(B)” where only “(A)” makes sense. Further, there is a perfectly reasonable explanation for why the PPACA would mean what it says: The PPACA’s authors sought to offer

¹⁶⁷ *Id.*

¹⁶⁸ *See infra.*

¹⁶⁹ *See, e.g., Lamie*, 540 U.S. (noting potential reasons Congress may have desired the result the alleged error created).

tax credits and subsidies as an incentive to encourage states to create Exchanges. For purposes of the scrivener’s-error test, it is sufficient to show that this interpretation is plausible. The PPACA’s legislative history, as recounted above, shows this explanation is not only plausible, but is actually the best explanation available.

B. Absurd Results

A related argument for discarding the plain meaning of the statutory text is that a literal application of the statutory text will produce such an absurd result that Congress could not have intended it.¹⁷⁰ As the Supreme Court explained in *United States v. Ron Pair Enterprises*, if “‘the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters,’ . . . the intention of the drafters, rather than the strict language, controls.”¹⁷¹ In such cases, an implementing agency or reviewing court would be justified in construing a statute in such a way as would prevent the absurd result. Again, however, this argument requires more than demonstrating that a literal application of the statutory text would be undesirable or

¹⁷⁰ See, e.g., *United States v. X-Citement Video, Inc.*, 513 U.S. 64, 68–69 (1994) (rejecting the “most natural grammatical reading” of a statute to avoid “absurd” results). The most famous, or perhaps infamous, application of this rule is *Holy Trinity Church v. United States*, 143 U.S. 457, 459–60 (1892) (“It is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit nor within the intention of its makers. . . . If a literal construction of the words of a statute be absurd, the act must be so construed as to avoid the absurdity.”). Since *Holy Trinity*, courts have become decidedly less willing to find that the plain language of a statute produces “absurd results” justifying an agency departure from the statutory text. See generally, John Manning, *The Absurdity Doctrine*, 116 HARV. L. REV. 2387 (2003); see also Andrew Gold, *Absurd Results, Scrivener’s Errors and Statutory Interpretation*, 75 U. CIN. L. REV. 25 (2006).

¹⁷¹ 489 U.S. 235, 242 (1989) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)).

objectionable to some portion of those who supported or advocated the law’s passage. It requires that the result would be truly “absurd” or unimaginable.¹⁷²

In order to avail itself of the “absurd results” argument, the IRS could argue that denying tax credits to otherwise qualifying individuals who reside in states that fail to create their own Exchanges would compromise the PPACA’s stated goal of increasing access to affordable health insurance, particularly if a large number of states were to refuse to create their own Exchanges. Specifically, one consequence of the PPACA imposing the community-rating requirement on health insurance sold in federal Exchanges without the presumably stabilizing influence of premium-assistance tax credits would be to destabilize insurance markets, as health insurance premiums would rise and many low-income families would be unable to afford health insurance as a result. Ensuring the availability of tax credits and subsidies in federal exchanges could address this problem. Yet the mere existence of unwanted effects from a statutory reform is insufficient to show that a statute will produce truly “absurd” results, let alone demonstrate that the language is different than that intended by Congress.

No legislation pursues a single goal without regard for costs or competing priorities.¹⁷³ However much legislators seek to pursue a particular goal, they may still conclude a statute “should reach so far and no farther.”¹⁷⁴ Trade-offs are omnipresent, and there is rarely a statute that does not contain some provision that tampers or moderates the statute’s overall goal. Further, and perhaps more importantly, a law reflects a deal or compromise made among

¹⁷² See, e.g., *Garcia v. United States*, 469 U.S. 70, 75 (1984) (“only the most extraordinary showing of contrary intentions” can justify ignoring statutory text); *United States v. Wiltberger*, 18 U.S. (5 Wheat.) 76, 96 (1820) (Marshall, C.J.) (“The case must be a strong one indeed, which would justify a Court in departing from the plain meaning of words . . . in search of an intention which the words themselves did not suggest.”).

¹⁷³ See Frank H. Easterbrook, *Statutes’ Domains*, 50 U. CHI. L. REV. 533, 541 (1983) (“No matter how good the end in view, achievement of the end will have some cost, and at some point the cost will begin to exceed the benefits.”).

¹⁷⁴ *Id.*

multiple legislative blocs, and rarely embodies all of one bloc’s preferences.¹⁷⁵ This is particularly true when, as here, legislation passes without a vote to spare. Thus there is no reason to privilege one group’s preferences or stated intent over the plain meaning of the statute that they all approved. And, as already suggested, there is an entirely plausible explanation for the statutory structure that Congress adopted: Conditioning the availability of tax credits on state creation of a health insurance Exchange was a method of encouraging state cooperation.¹⁷⁶

Even though restricting tax credits to state-run Exchanges could frustrate the law’s goal of expanding health insurance coverage, this would not be a sufficiently “absurd” result to justify disregarding the plain text of the Act. The plain meaning of section 1401 is not absurd for the same reason it is not implausible that Congress could have meant what it said: the lack of tax credits in federal Exchanges is just one manifestation of PPACA supporters’ willingness to induce adverse selection in insurance markets in pursuit of other goals.

For those who find it implausible Congress would enact health insurance regulations that could destabilize markets and reduce coverage, the exchange provisions are but one example of Congress doing exactly that through the PPACA. In at least two other instances, Congress displayed an even higher tolerance for iatrogenic instability than what it created in federal Exchanges. PPACA’s legislative history provides further evidence of this tolerance.

One example is the Act’s imposition of community-rating price controls on health insurance for children. The Act imposed these price controls with neither a mandate nor subsidies to encourage low risks to remain in the market. This provision took effect on September 23, 2010—six months after the PPACA’s enactment, and more than three years

¹⁷⁵ See William M. Landes & Richard A. Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J.L. & ECON. 875, 876 (1975); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL. J. ECON. & MGMT. SCI. 3, 3 (1971).

¹⁷⁶ This structure also served to provide the Senate Finance Committee with jurisdiction over the bill. See *infra*.

before families with children would become subject to the individual mandate or be eligible for tax credits or subsidies. As a result, 39 states reported that at least one carrier left the child-only market, and in 17 of those states the market completely collapsed. In some cases, the PPACA caused the market to collapse before the price controls even took effect.¹⁷⁷

Another example is a new government-run long-term care insurance program authorized by PPACA and known as the Community Living Assistance Services and Supports Act, or CLASS Act. By law, premiums in that program may not vary according to an applicant's risk. Congress neither imposed a mandate requiring low-risk individuals to participate in this program, nor created tax credits or subsidies to encourage low risks to participate. Prior to enactment, independent observers warned that the community-rating price controls would induce adverse selection and make the program highly unstable,¹⁷⁸ a reality the Obama administration acknowledged in 2011.¹⁷⁹ Congress enacted it anyway.

¹⁷⁷ U.S. SENATE, COMM. ON HEALTH, EDUCATION, LABOR AND PENSIONS, RANKING MEMBER REPORT: HEALTH CARE REFORM LAW'S IMPACT ON CHILD-ONLY HEALTH INSURANCE POLICIES (Aug. 2, 2011), *available at*: <http://www.help.senate.gov/imo/media/doc/Child-Only%20Health%20Insurance%20Report%20Aug%20202011.pdf>.

¹⁷⁸ CENTERS FOR MEDICARE AND MEDICAID SERVICES, OFFICE OF THE ACTUARY, ESTIMATED FINANCIAL EFFECTS OF THE 'AMERICA'S AFFORDABLE HEALTH CHOICES ACT OF 2009' (H.R. 3962), AS PASSED BY THE HOUSE ON NOVEMBER 7, 2009 (Nov. 13, 2009), *available at*: http://www.cms.gov/Research-Statistics-Data-and-Systems/Research/ActuarialStudies/downloads/HR3962_2009-11-13.pdf. *See also* AMERICAN ACADEMY OF ACTUARIES, CRITICAL ISSUES IN HEALTH REFORM COMMUNITY LIVING ASSISTANCE SERVICE AND SUPPORTS ACT (CLASS) (Nov. 2009), *available at*: http://www.actuary.org/pdf/health/class_nov09.pdf; CENTERS FOR MEDICARE AND MEDICAID SERVICES, OFFICE OF THE ACTUARY, ESTIMATED FINANCIAL EFFECTS OF THE 'PATIENT PROTECTION AND AFFORDABLE CARE ACT,' AS AMENDED (Apr. 22, 2010), https://www.cms.gov/Research-Statistics-Data-and-Systems/Research/ActuarialStudies/downloads/PPACA_2010-04-22.pdf; DEP'T OF HEALTH AND HUMAN SERVICES, OFFICE OF THE CLASS ACTUARY, ACTUARIAL REPORT ON THE DEVELOPMENT OF CLASS BENEFIT PLANS 33-35 (Sept. 20, 2011), *available at*: <http://aspe.hhs.gov/daltcp/reports/2011/class/appO.pdf> ("It is not a coincidence that many experts have maintained that adverse selection is the major obstacle for the CLASS program. Any workable design must address it in order to receive certification as an actuarially sound plan").

¹⁷⁹ Sam Baker, *HHS decision erases nearly \$100B of projected savings from reform law*, THE HILL'S HEALTHWATCH, Oct. 14, 2011, <http://thehill.com/blogs/healthwatch/health-reform-implementation/187727-hhs-decision-erases-nearly-100b-of-projected-savings-from-reform-law> ("The Obama administration's decision Friday to scrap a controversial insurance program wiped out nearly \$100 billion of the projected savings from the healthcare reform law. Officials at the Health and Human Services Department announced they will no longer try to implement the CLASS program, which was designed to provide insurance for long-term care. By suspending the CLASS Act, HHS also erases about 40 percent of the savings the healthcare reform was supposed to generate for the government.").

These examples show that the lack of tax credits in federal Exchanges is consistent with the high tolerance for adverse selection evident elsewhere in the Act, and reinforces that this is not the sort of “absurd” result that would justify ignoring clear statutory text. Congress clearly contemplated allowing community-rating price controls to operate in the absence of credits or subsidies that might mitigate the resulting instability. Since PPACA does more to mitigate adverse selection in federal Exchanges than in either the child-only market or the CLASS Act—Congress imposed an individual mandate that would take effect at the same time federal Exchanges would begin operating—there is nothing about the lack of tax credits in federal Exchanges to suggest a departure from congressional intent, absurd or otherwise. Each of these three features, moreover, appeared in one or both of the PPACA’s antecedents.¹⁸⁰

Some supporters of the rule might offer the following absurd-results argument in an effort to show that the exchange provisions produce absurd results across the board. The plain text of Section 1312 appears to limit access to health insurance Exchanges to individuals who reside “in the state that established the Exchange.”¹⁸¹ Taken literally, this subsection would

One might argue that the CLASS Act is not an apt example of PPACA supporters’ tolerance for adverse selection, because the law requires it to be self-sustaining and HHS has suspended implementation due to the Department’s inability to develop a sustainable model for the program. But if the IRS were to claim Congress would not have enacted community-rating price controls without also subsidizing low-risk consumers, the CLASS Act is an example of Congress doing just that. Moreover, the non-partisan Congressional Research Service has written that federal courts could order HHS to implement the CLASS Act even if it is not sustainable. See Avik Roy, *Congressional Research Service: Courts Could Force HHS to Implement CLASS Act, Despite Its Insolvency*, FORBES, Feb. 1, 2012, <http://www.forbes.com/sites/aroy/2012/02/01/congressional-research-service-courts-could-force-hhs-to-implement-class-act-despite-its-insolvency/>.

¹⁸⁰ Affordable Health Choices Act, S. 1697, 111th Cong. Sec. 190 and Sec. 191, pp. 228-281, (2009). ; Affordable Health Choices Act, S. 1697, 111th Cong. Sec. 101, pp. 8-30, (2009); America’s Healthy Future Act of 2009, S. 1796, 111th Cong. Sec. 1001, pp. 14-24 (2009).

¹⁸¹ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1312, 124 Stat. 184 (2010) amended by Sec. 10104(i) of the Patient Protection and Affordable Care Act of 2010:

(f) QUALIFIED INDIVIDUALS AND EMPLOYERS; ACCESS LIMITED TO CITIZENS AND LAWFUL RESIDENTS.—

(1) QUALIFIED INDIVIDUALS.—In this title:

mean that no one would be eligible to purchase health insurance through a federal Exchange, because no *state* established that Exchange. This cannot have been Congress’ intent. It would be absurd to claim that Congress wanted the federal government to create fallback Exchanges yet not allow anyone to enroll in them. The only reasonable interpretation is that Congress intended for all the same rules to apply to federal and state-run Exchanges.

Assuming *arguendo* that this language does not reflect congressional intent, it nevertheless would not create an absurd result that would allow the IRS to override the clear language of Section 1401. The possibility that a literal reading of the language governing individuals’ eligibility *to enter an Exchange* might lead to an absurd result does not imply that the language governing individuals’ eligibility *for tax credits within an Exchange* also produces an absurd result. Put differently, if Congress intended to allow qualified individuals to enter either state-run or federal Exchanges, then that fact would not imply that Congress intended for them to be able to access tax credits through both types of Exchange. Indeed, all the foregoing evidence demands the opposite conclusion. It is entirely possible that Congress intended state-run and federal Exchanges to be similar in some ways but different in others, and that is what the plain language of the Act and its antecedent bills require. Even if Section 1312 produces a literal absurdity, the text of Section 1401 does not. It laboriously restricts tax credits to state-run Exchanges (“established by a state” and “under Section 1311”). When viewed in the light of the rest of the Act, and the Finance and HELP committee bills, the evidence overwhelmingly shows that Congress did not intend to authorize tax credits in both types of Exchange. To conclude

(A) IN GENERAL.—The term “qualified individual” means, with respect to an Exchange, an individual who—

(i) is seeking to enroll in a qualified health plan in the individual market offered through the Exchange; and

(ii) resides in the State that established the Exchange.

otherwise would undermine congressional intent by disregarding the express language of Section 1401 and draining Section 1311’s “shall” of force and meaning.

Even if the consequences of enforcing the plain language of Section 1401 would strike *some* as “absurd,” this does not give the IRS “license to rewrite the statute.”¹⁸² Rather, where an agency concludes that literal enforcement of the statutory text would thwart congressional intent “it may deviate no further from the statute than is needed to protect congressional intent.”¹⁸³ This, in turn, calls upon a reviewing court to consult other sources of legislative intent so as to ensure that the law in question is applied as intended.¹⁸⁴

C. *Chevron* Deference

Another argument in support of the IRS rule is that the IRS should receive *Chevron* deference in its interpretation of the relevant PPACA provisions. According to Professor Jost, the IRS’ interpretation should prevail, if for no other reason than under *Chevron USA v. Natural Resources Defense Council*¹⁸⁵ the “official construction of an ambiguous statute should be accorded deference by any reviewing court.”¹⁸⁶ Thus even if Section 1401 appears to be clear and unambiguous when read in isolation, the IRS could argue that the text and structure of the law as a whole creates sufficient ambiguity about the operation of this provision to trigger

¹⁸² See *Mova Pharm. Corp. v. Shalala*, 140 F.3d 1060, 1068 (D.C. Cir. 1998).

¹⁸³ *Id.*

¹⁸⁴ See *Public Citizen v. U.S. Department of Justice*, 491 U.S. 440, 454 (1989) (“Where the literal reading of a statutory term would ‘compel an odd result,’ we must search for other evidence of congressional intent to lend the term its proper scope.”).

¹⁸⁵ 467 U.S. 837 (1984).

¹⁸⁶ Timothy S. Jost, *Yes, the Federal Exchange Can Offer Premium Tax Credits*, HEALTH REFORM WATCH, Sept. 11, 2011, <http://www.healthreformwatch.com/2011/09/11/yes-the-federal-exchange-can-offer-premium-tax-credits/>.

Chevron deference.¹⁸⁷ So, for instance, Jost argues the HCERA “creates an ambiguity in the law that the IRS can resolve through its rule-making power.”¹⁸⁸ Here again, arguments in defense of the IRS rule falter.

Chevron outlined a two-step inquiry for courts to apply when evaluating agency interpretations of federal statutes. In step one, the reviewing court considers the statutory text to determine “whether Congress has directly spoken to the precise question at issue.”¹⁸⁹ If so, the statute controls, “for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.”¹⁹⁰ If the reviewing court concludes that the statute is “silent or ambiguous,” however, and determines that interpretive authority has been delegated to the agency, the court must defer to the agency’s statutory interpretation, so long as it “is based on a permissible construction of the statute.”¹⁹¹ At this second step, the agency’s interpretation is given “controlling weight” unless it is “arbitrary, capricious, or manifestly contrary to the statute.”¹⁹²

Although there has been some suggestion that *Chevron* is not applicable to IRS or even Treasury Department regulations, the Supreme Court has recently reaffirmed that this approach applies “with full force in the tax context.”¹⁹³ “Filling gaps in the Internal Revenue Code plainly

¹⁸⁷ The Supreme Court has endorsed the idea that statutory provisions should be read in light of the entire statutory structure. *See, e.g.,* Food & Drug Admin. v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000) (A court must . . . interpret the statute “as a symmetrical and coherent regulatory scheme”). (internal quotation omitted)).

¹⁸⁸ David Hogberg, *Companies Could Challenge ObamaCare Employer Fines*, INVESTOR’S BUSINESS DAILY, Sept. 16, 2011, <http://news.investors.com/article/585053/201109161746/companies-could-challenge-obamacare-employer-fines.htm>.

¹⁸⁹ *Chevron*, 467 U.S. at 842.

¹⁹⁰ *Id.* at 842-43.

¹⁹¹ *Id.* at 843.

¹⁹² *Id.* at 844.

¹⁹³ *See Mayo Foundation for Medical Education and Research v. United States*, 131 S.Ct. 704, 713 (2011).

requires the Treasury Department to make interpretive choices for statutory implementation,¹⁹⁴ but the Treasury Department (and IRS) are entitled to no extra leeway or special treatment. Further, while *Chevron* is quite permissive to agency interpretations, such deference *only* applies once a court has concluded a statute is ambiguous. The reviewing court owes the agency “no deference” on the question of whether a statute is ambiguous in the first place.¹⁹⁵

In matters where the IRS’s interpretation of a statute creates a tax that Congress did not expressly authorize, the agency’s interpretation is arguably due less deference than normal. The framers of the Constitution considered the power to tax so dangerous that they required that “All Bills for raising Revenue shall originate in the House of Representatives”¹⁹⁶ because that chamber is closest to the people. If an IRS rule attempts something that the Constitution forbids even to the Senate, that rule deserves heightened scrutiny.

Ambiguity alone does not trigger *Chevron* deference, however.¹⁹⁷ As the Court has made clear in recent years, most notably in *United States v. Mead Corp.*,¹⁹⁸ the basis for according deference to agency interpretations of ambiguous statutes is the conclusion that Congress has delegated such interpretive authority to the agency. *Chevron* applies only “when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that

¹⁹⁴ *Mayo Fdn*, 131 S.Ct. at 713.

¹⁹⁵ *See Ry. Labor Exec. Ass’n v. Nat’l Mediation Bd.*, 29 F.3d 655, 671 (D.C.Cir.1994) (en banc) (The first question, whether there is such an ambiguity, is for the court, and we owe the agency no deference on the existence of ambiguity.”) (internal citation omitted).

¹⁹⁶ *U.S. Const.* art. I, § 7.

¹⁹⁷ *See Michigan v. EPA*, 268 F.3d 1075, 1082 (D.C.Cir.2001) (“Mere ambiguity in a statute is not evidence of congressional delegation of authority.”) (citations omitted).

¹⁹⁸ 533 U.S. 218 (2001).

authority.”¹⁹⁹ Further, notes Professor Adrian Vermeule, “the default rule runs against delegation. Unless the reviewing court affirmatively finds that Congress intended to delegate interpretive authority to the particular agency at hand, in the particular statutory scheme at hand, *Chevron* deference is not due and the *Chevron* two-step is not to be invoked.”²⁰⁰

The IRS’ primary argument is that its interpretation is “consistent with” the statute and that there is no evidence in “the relevant legislative history” to “demonstrate that Congress intended to limit the premium tax credit to State Exchanges.”²⁰¹ In effect, the IRS is arguing that since the PPACA does not preclude the agency’s interpretation, that interpretation should control.

This rationale for the rule cannot satisfy *Chevron* step one. To claim that an agency action is consistent with a statute is not even an assertion, much less a showing of ambiguity. A lack of evidence (in the “relevant” legislative history) that Congress intended to forbid an agency action is likewise not enough to demonstrate a statutory ambiguity, let alone to justify *Chevron* deference. Agencies have no inherent powers, only delegated ones.²⁰² Agencies, including the IRS, “are creatures of statute . . . [that] may act only because, and only to the extent that, Congress affirmatively has delegated them the power to act.”²⁰³ When Congress is silent on a

¹⁹⁹ *Mead*, 533 U.S. at 226–27; see also *Adams Fruit Co. v. Barrett*, 494 U.S. 638, 649 (1990); *Dunn v. Commodity Futures Trading Comm’n*, 519 U.S. 465, 479 n.14 (1997) (explaining that *Chevron* deference “arises out of background presumptions of congressional intent” (citing *Smiley v. Citibank (S.D.)*, 517 U.S. 735, 740–41 (1996))); *Merrill & Hickman*, at 863 (observing that “[t]he Court . . . has rather consistently opted for the congressional intent theory” as the legal foundation for *Chevron* deference).

²⁰⁰ See Adrian Vermeule, *Introduction: Mead in the Trenches*, 71 GEO. WASH. L. REV. 347, 348 (2003).

²⁰¹ Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 77 FEDERAL REGISTER 30378 (May 23, 2012), available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf>.

²⁰² See *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988) (“It is axiomatic that an administrative agency’s power to promulgate legislative regulations is limited to the authority delegated by Congress.”); *La. Pub. Serv. Comm’n v. FCC*, 476 U.S. 355, 374 (1986) (“[A]n agency literally has no power to act . . . unless and until Congress confers power upon it.”).

²⁰³ *American Bus Ass’n v. Slater*, 231 F.3d 1, 9 (D.C. Cir. 2000) (Sentelle, j., concurring).

question, such as whether an agency has authority to issue tax credits, or authorize entitlement spending in the form of refundable credits or cost-sharing subsidies, or levy taxes on employers, one should presume that the authority does not exist.

The D.C. Circuit has expressly rejected the proposition that *Chevron* step one is satisfied “any time a statute does not expressly *negate* the existence of a claimed administrative power.”²⁰⁴ In *American Bar Association v. Federal Trade Commission*, for example, the court forcefully rejected the FTC’s claim that it could interpret a statute to provide a source of regulatory authority because “no language in the statute” expressly provided otherwise.²⁰⁵ Similarly, in *Railway Labor Executives’ Association v. National Mediation Board*, the D.C. Circuit rejected the proposition that an agency could “*presume* delegation of power from Congress absent an express *withholding* of such power.”²⁰⁶ As the Court explained:

To presume . . . that *Chevron* step two is implicated any time a statute does not expressly *negate* the existence of a claimed administrative power (*i.e.* when the statute is not written in “thou shalt not” terms), is . . . flatly unfaithful to the principles of administrative law.²⁰⁷

Even if the IRS were able to satisfy *Chevron* step one by convincing a court that the relevant portions of the PPACA are sufficiently ambiguous to justify an IRS interpretation, the IRS rule would still fail. Reaching step two of the *Chevron* test does not give agencies free rein. For an agency’s interpretation to prevail at step two, it must still be consistent with the relevant statutory text. Thus even if the IRS could demonstrate that the PPACA is ambiguous, it would have to argue that its rule is consistent with what Congress actually enacted and the President signed into law. As the foregoing discussion of the statute’s text, structure, and history should

²⁰⁴ *Ry. Labor Executives’ Ass’n v. Nat’l Mediation Bd.*, 29 F.3d 655, 671 (D.C. Cir. 1994); *see also* *Am. Bar Ass’n v. FTC*, 460 F.3d 457, 468 (D.C. Cir. 2005)(same).

²⁰⁵ *Am. Bar Ass’n*, 430 F.3d at 468.

²⁰⁶ *Ry. Labor Executives’ Ass’n*, 29 F.3d at 659 (emphasis in original).

²⁰⁷ *Id.* at 671.

make clear, this would be difficult to do. The IRS’s interpretation is decidedly inconsistent with the statute’s repeated and consistent use of language restricting tax credits to Exchanges “established by the state under section 1311.”

Suppose, however, the IRS were able to convince a reviewing court that the PPACA is ambiguous on whether it limits tax credits to state-based Exchanges. The IRS would also need to demonstrate that this ambiguity was evidence of an implicit delegation of authority to interpret the statute in a way that would authorize the creation of new tax credits, new entitlement spending, and new taxes on employers and individuals, beyond the purview of the traditional legislative appropriations process. This is not the sort of authority one should lightly presume Congress delegated to an Agency. To paraphrase the Supreme Court, Congress does not hide such “elephants in mouseholes.”²⁰⁸

If an ambiguity of that sort were sufficient to trigger full *Chevron* deference to this sort of agency action, ambiguities in tax-related statutes could become so substantial a fount of IRS power that it would raise difficult constitutional questions.²⁰⁹ Article I, Section 8 vests all legislative power in the Congress, and Article I, Section 9 provides that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law.”²¹⁰ For an agency to claim unilateral authority to interpret a statute so as to draw money from the Treasury – in this case, through entitlement spending in the form of refundable tax credits and cost-sharing subsidies – is to assert authority of questionable constitutional validity. The same applies to the

²⁰⁸ See *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457 (2001) (“[Congress] does not ... hide elephants in mouseholes.”).

²⁰⁹ See Jonathan T. Molot, *Reexamining Marbury in the Administrative State: A Structural and Institutional Defense of Judicial Power over Statutory Interpretation*, 96 NW. U. L. REV. 1239, 1282 (2002) (“If administrators were given final authority on issues of statutory construction this shift in power would substantially undermine our constitutional commitment to representative government.”).

²¹⁰ *U.S. Const. art. I, § 8, § 9.*

taxing power, which the Constitution likewise reserves solely to Congress.²¹¹ It is a longstanding principle that courts are to avoid those statutory interpretations that would raise difficult constitutional questions.²¹² This is true even where a statute is sufficiently ambiguous that it might otherwise justify *Chevron* deference.²¹³

It would be one thing if Congress were to expressly delegate authority to the IRS to provide premium assistance under general conditions that the IRS could then clarify and define. Here, however, the IRS is claiming the authority to authorize tax credits and entitlement spending beyond the express limits imposed by Congress. Yet the IRS’ position is not that its interpretation is compelled by the PPACA, only that it is “consistent with” it. This means the decision to provide such tax credits and cost-sharing subsidies is being made not by Congress, where such power has been vested, but by the IRS. The IRS position, at heart, is that Congress has enacted an ambiguous statute and thereby delegated to the IRS the discretionary authority to decide whether or not tax credits, subsidies, and taxes are authorized in states that do not establish Exchanges. This is authority Congress would not grant lightly, and is certainly not the sort of authority to be found in an alleged ambiguity within statutory text. Thus even if one were to conclude Section 1401 of the PPACA is ambiguous, it would still not justify deference to the IRS.

Supporters of the rule point to language in the PPACA granting the IRS authority to promulgate regulations to implement the law as authority for the IRS rule. Professor Jost, for

²¹¹ *U.S. Const. art. I, § 8.*

²¹² *See, e.g.,* Edward J. DeBartolo Corp. v. Florida Gulf Coast Building & Constr. Trades Council, 485 U.S. 568, 575 (1988) (“where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress.”); *Bowen v. Georgetown University Hospital*, 488 U.S. 204, 208-09 (1988).

²¹³ *See* *Solid Waste Agency North. Cook Cty. v. U.S. Army Corps of Engineers*, 531 U. S. 159 (2001) (“Where an administrative interpretation of a statute invokes the outer limits of Congress’ power, we expect a clear indication that Congress intended that result.”).

example, argues, “Section 36B(g) gives the Secretary of the Treasury the responsibility of issuing regulations to implement section 36B. This includes the authority to reconcile ambiguities in the statute, such as the inconsistency” created by the information-reporting requirement.²¹⁴ Yet giving the Secretary the power to “prescribe such regulations as may be necessary to carry out the provisions of this section”²¹⁵ does not give the Secretary the power to issue this rule. It is not necessary to impose unauthorized taxes, issue unauthorized tax credits, dispense unauthorized subsidies to private health insurance companies, or create two unauthorized entitlements for individuals, in order to implement the one entitlement section 1401 does authorize, or to carry out its reporting requirement. Nor is it necessary to *alter* the “aggregate amount[s] of any advance payment[s] of such credit or reductions”²¹⁶ in order to *report* on those amounts, or otherwise carry out the provisions of this section. Subsection 36B(g) simply does not give the IRS the authority to issue this rule.

Supporters of the IRS rule claim to have found one potential source of statutory ambiguity in section 1321. As noted above, section 1321 provides that if a state fails to create the “required Exchange” or fails to create an Exchange that complies with federal requirements, “the Secretary shall (directly or through agreement with a not-for-profit entity) establish and operate *such Exchange* within the State and the Secretary shall take such actions as are necessary to implement such other requirements.”²¹⁷ According to Professor Jost:

By “such Exchange” Congress meant the “required exchange” mandated by section 1311. Thus when several subsequent sections refer to “an Exchange established by the State under section 1311,” including the provisions of Internal Revenue Code section 36B . . .

²¹⁴ Timothy S. Jost, *Yes, the Federal Exchange Can Offer Premium Tax Credits*, HEALTH REFORM WATCH, Sept. 11, 2011, <http://www.healthreformwatch.com/2011/09/11/yes-the-federal-exchange-can-offer-premium-tax-credits/>.

²¹⁵ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1401, 124 Stat. 119, 219 (2010).

²¹⁶ Health Care and Education Reconciliation Act, Pub. L. No. 111-152, Sec. 1004, 124 Stat. 1029, 1035 (2010) (amends I.R.C. § 36B(f)).

²¹⁷ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1321(c), 124 Stat. 119, 186 (2010).

they are referring both to state exchanges and to “such exchanges” established within states by the Secretary.²¹⁸

In this account, Section 1321’s reference to “such exchange” either shoehorns Section 1321 Exchanges into Section 1311, or at least creates sufficient ambiguity to allow for the interpretation offered by the IRS. Neither claim can be squared with the statute.

Professor Jost cites the definition of Exchanges the PPACA inserts into Section 2791(d) of the Public Health Service Act:²¹⁹

Section 1563(b) of the ACA states: “The term ‘Exchange’ means an American Health Benefit Exchange established under section 1311 of the Patient Protection and Affordable Care Act.” Section 1311 literally requires that the states “shall” establish an American Health Benefits Exchange by January 1, 2014. Because the Constitution prohibits the federal government from literally requiring states to establish exchanges, however, section 1321(c), provides that “the [HHS] Secretary shall (directly or through agreement with a not-for-profit entity) establish and operate such Exchange within the State.” Under the ACA’s definition of exchange, the term ‘Exchange’ in section 1321 exchange means a section 1311 exchange.²²⁰

He presents this as the plain meaning of Section 1321, rather than an ambiguity-based argument, because he maintains there are no conflicts between Section 1401 and any other part of the statute.²²¹ Yet a plain reading of the statute cannot support this claim. Section 1401 expressly and

²¹⁸ Jost, HEALTH AFFAIRS BLOG, *supra*.

²¹⁹ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119, 264 (2010) (Amends 42 U.S.C. § 300gg–91(d)).

²²⁰ *IRS: Enforcing ObamaCare’s New Rules and Taxes, Before The House Comm. on Oversight and Government Reform*, 111th Cong. 3 (Aug. 2, 2012) (Testimony of Timothy S. Jost), available at: <http://oversight.house.gov/wp-content/uploads/2012/08/Jost-Testimony.pdf>. Note that the PPACA contains three separate Sections 1563.

²²¹ *IRS: Enforcing ObamaCare’s New Rules and Taxes, Before The House Comm. on Oversight and Government Reform*, 111th Cong. 3 (Aug. 2, 2012) (Note: unofficial transcript), video available at: <http://oversight.house.gov/hearing/irs-enforcing-obamacares-new-rules-and-taxes/> (begins at 58:46).

Rep. Scott DesJarlais (R-TN): Mr. Cannon, is there anything stopping the IRS from implementing section 36B of the Internal Revenue Code exactly as written?

Michael Cannon: 36B is large and complicated sir. If what you mean is the provision restricting tax credits to state-run exchanges, no.

DesJarlais: Thank you. Mr. Jost. Professor Jost.

Timothy Jost: 36B, as I explained, if you read the definitions does offer federal exchanges to issue a tax credit, so no there’s no problem.

repeatedly restricts tax credits to Exchanges “established by the State under section 1311.” Even if Section 1321’s “such Exchange” referred to a Section 1311 exchange, it would still not square with Section 1401’s requirement that an exchange “established by a state.” Section 1311 also lists among its “requirements” that for purposes of that section, “An Exchange shall be a governmental agency or nonprofit entity that is established by a State.”²²² The notion that a Section 1321 Exchange *is* a Section 1311 Exchange reduces to the absurd claim that the PPACA directs the federal government to establish an Exchange that is “established by a state.” It “violates [the] canon of statutory construction...that every provision of a congressional

DesJarlais: There’s no problem. Thank you. In one part of the law it authorizes tax credits for people who purchase a qualified health plan through an exchange established by the state under section 1311. And even people who defend the IRS on this issue such as yourself, professor Jost, say this part of the law is clear. Is there any part of the statute that prevents you from doing just that, offering tax credits only in state-run exchanges.

Jost: Again the definitions.

DeJarlais: Mr. Cannon. Is there any part of the statute that prevents you from doing just that, offering tax credits? No?

Cannon: No, in fact the statute requires that.

DesJarlais: Okay, Is there any part of the statute conflicts with that? Mr. Cannon.

Cannon: No in fact all other elements of the law support the clear meaning of that limitation of tax credits to health insurance exchanges established by the state under section 1311. And established by the state, those words are key.

DeJarlais: What about the information reporting requirement?

Cannon: That does not conflict. It does require exchanges established under section 1321, by the federal government, to report information related to eligibility for tax credits and the advance payments of tax credits to the treasury secretary and to individuals enrolled through those exchanges. But that does not conflict in any way with the limitation of tax credits to state-run exchanges.

DeJarlais: So what is stopping the IRS from implementing the tax credit provision exactly as written and the exchanges from implementing the information reporting requirement exactly as written? Or can they both be implemented exactly as written without conflicting with each other?

Cannon: The latter. They can both be implemented exactly as written without any conflict.

DeJarlais: Agree professor Jost?

Jost: I would agree because, again, federal exchanges can issue premium tax credits and can report.

²²² Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1311(d)(1), 124 Stat. 119, 176 (2010).

enactment should be given effect”²²³ because it would strip these provisions in Sections 1311 and 1401 of their meaning. Finally, Professor Jost’s “such Exchange” defense of the IRS rule is contradicted by another argument he offers in defense of the rule: that “Congress demonstrated its understanding that federal exchanges would administer premium tax credits”²²⁴ when the HCERA imposed the same information-reporting requirement on Exchanges established, in the words of the statute, “under section 1311(f)(3) or 1321(c)”.²²⁵ If, as Professor Jost claims, a “section 1321 exchange means a section 1311 exchange,” there would have been no need for Congress to mention Section 1321 in the information-reporting requirement. Professor Jost’s “such Exchange” defense would therefore render this provision redundant as well.

Professor Jost is nevertheless correct that there is no conflict between Section 1401 and Section 1321 or any other provision of the statute. Section 1321’s command that the Secretary shall establish “such Exchange”²²⁶ directs the federal government to create Exchanges that are identical to Section 1311 Exchanges, except where Congress has provided otherwise.

D. The “CBO Canon”

A rather novel defense of the IRS rule is that the IRS has authority to issue it because it is consistent with the manner in which the Congressional Budget Office scored the PPACA.²²⁷

²²³ *IRS: Enforcing ObamaCare’s New Rules and Taxes, Before The House Comm. on Oversight and Government Reform*, 111th Cong. 3 (Aug. 2, 2012), available at: <http://oversight.house.gov/wp-content/uploads/2012/08/Jost-Testimony.pdf>.

²²⁴ Timothy S. Jost, *Yes, the Federal Exchange Can Offer Premium Tax Credits*, HEALTH REFORM WATCH, Sept. 11, 2011, <http://www.healthreformwatch.com/2011/09/11/yes-the-federal-exchange-can-offer-premium-tax-credits/>.

²²⁵ Health Care and Education Reconciliation Act, Pub. L. No. 111-152, Sec. 1004, 124 Stat. 1029, 1035 (2010).

²²⁶ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1321(c), 124 Stat. 119, 186 (2010).

²²⁷ See Abbe Gluck, *The “CBO Canon” and the Debate Over Tax Credits on Federally Operated Health Insurance Exchanges*, BALKINIZATION, July 10, 2012, available at: <http://balkin.blogspot.com/2012/07/cbo-canon-and-debate-over-tax-credits.html>. See also Shulman letter, *supra*.

Specifically, the argument is that the CBO score, including the revenue analysis of the law by the Joint Committee on Taxation, are evidence that the law was ambiguous and can be interpreted to support the IRS regulation. As Professor Jost explains:

the Joint Committee on Taxation and Congressional Budget Office assumed that the tax credits will be available through the federal exchange. This is how the IRS and HHS have interpreted the law...and is clearly what Congress intended.²²⁸

If the actions of the CBO and JCT are not enough, in themselves, to demonstrate Congressional intent, Professor Abbe Gluck argues that there should be an “interpretive presumption” that statutory ambiguities “should be construed in the way most consistent with the assumptions underlying the congressional budget score on which the initial legislation was based.”²²⁹

According to Gluck, because Congress “drafts in the shadow” of CBO budget scores, the CBO score “offers better evidence of congressional ‘intent’ than other commonly consulted non-textual tools, including legislative history.”²³⁰ Alternatively, if the CBO score is not evidence that the statute supports the IRS rule, the existence of a CBO score consistent with the rule could at least suggest that the statute is sufficiently ambiguous to allow for the rule.

This theory of statutory construction raises interesting questions, none of which need be addressed here. The CBO score of the PPACA’s exchange provisions is entirely consistent with the plain text of the statute and the prevailing assumptions about how these provisions would operate in practice.²³¹ The Joint Committee on Taxation and Congressional Budget Office

²²⁸ Timothy Jost, *Implementing Reform: Funding And Flexibility For States On Exchanges*, HEALTH AFFAIRS BLOG, Nov. 30, 2011, <http://healthaffairs.org/blog/2011/11/30/implementing-reform-funding-and-flexibility-for-states-on-exchanges/>. IRS Commissioner Douglas Shulman has also made this argument. See John Gramlich, *GOP Prepares Efforts to Challenge IRS Rule on Health Insurance Subsidies*, CQ TODAY, July 10, 2012.

²²⁹ Gluck, *supra*.

²³⁰ *Id.*

²³¹ Robert Pear, *U.S. Officials Brace for Huge Task of Operating Health Exchanges*, NY TIMES, Aug. 5, 2012, available at: <http://www.nytimes.com/2012/08/05/us/us-officials-brace-for-huge-task-of-running-health->

produced revenue and spending estimates that assumed tax credits would be available in all 50 states. But this is not the same as “assum[ing] that the tax credits will be available through the federal exchange,” and neither the CBO nor JCT stated such an assumption when conducting their analysis. Rather, like many of the PPACA’s supporters, it appears the CBO and JCT simply assumed that every state would create its own exchange, and incorporated that miscalculation in their projections. Further evidence for this interpretation is that the CBO did not account for the hundreds of millions of dollars it would take to establish and operate federally run exchanges (just as Congress didn’t authorize those funds). Thus, in all likelihood the CBO either assumed every state would establish its own exchange or did not even consider the question at all. In either case, there is no basis to rely upon the CBO (or JCT) to overturn or alter the plain meaning of the PPACA’s text.

VI. Standing to Challenge the IRS Rule

The fact that the IRS rule exceeds the scope of the authority Congress delegated the agency and is contrary to law does not necessarily mean there is recourse. It can be particularly difficult to challenge IRS implementation, particularly where, as here, the IRS’ alleged malfeasance consists of granting tax benefits and federal subsidies to other people. As Professor Jost initially argued, “there will be no judicial review of this determination. It is not possible to conceive of a person who would be injured in fact by this interpretation of the rule such that they could present a case or controversy under Article III.”²³² In the normal case, this could be true.

[exchanges.html](#) (“When Congress passed legislation to expand coverage two years ago, Mr. Obama and lawmakers assumed that every state would set up its own [exchange](#)[.]”).

²³² Timothy S. Jost, *Yes, the Federal Exchange Can Offer Premium Tax Credits*, HEALTH REFORM WATCH, Sept. 11, 2011, <http://www.healthreformwatch.com/2011/09/11/yes-the-federal-exchange-can-offer-premium-tax-credits/>.

Given how Section 1401 interacts with the rest of the PPACA’s intricate regulatory structure, however, there could be standing to challenge the IRS rule.²³³

A plaintiff must have Article III standing in order to challenge the legality of a federal agency action in federal court. Specifically, under *Lujan v. Defenders of Wildlife* the “irreducible constitutional minimum of standing” has three parts.²³⁴ First, the “plaintiff must have suffered an ‘injury in fact,’” that is both “actual or imminent” and “concrete and particularized.”²³⁵ Second, there must be a “causal connection between the injury and the conduct complained of.”²³⁶ Third, there must be a sufficient likelihood that the “the injury will be ‘redressed by a favorable decision.’”²³⁷ When an individual or corporation is the subject of a government action, standing is relatively easy to satisfy. A plaintiff always has standing to challenge a government action that is directed against him. So, for instance, an individual or corporation would have standing to challenge the imposition of allegedly illegal tax assessed against them.²³⁸

²³³ Professor Jost has since acknowledged this point. See Jost, HEALTH AFFAIRS BLOG, *supra* (“The only viable challengers to the law are employers who may in the future have to pay an exaction because they fail to offer their employees insurance (or affordable or adequate insurance) and their employees consequently end up receiving tax credits in the federal exchanges.”). Though he may be wrong about employers being the only viable challengers. See *infra*.

²³⁴ 504 U.S. 555, 560 (1992). See also *NE Fla. Chap. of Associated Gen. Contractors of Amer. v. City of Jacksonville, Fla.*, 508 U.S. 656, 663 (1993) (restating the minimum requirements of Article III standing articulated in *Lujan*); *U.S. v. Hays*, 515 U.S. 737, 742–43 (1995) (same); *Bennett v. Spear*, 520 U.S. 154, 162 (1997) (same); *Steel Co. v. Citizens for a Better Evt*, 523 U.S. 83, 102–03 (1998) (same); *Friends of the Earth, Inc. v. Laidlaw Evtl Svcs, Inc.*, 528 U.S. 167, 180–81 (2000) (same).

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ *Id.* at 561 (quoting *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 38 (1976)).

²³⁸ While standing is easy to establish in such cases, there may be other barriers to obtaining prompt judicial review. The Anti-Injunction Act, for example, provides that, as a general rule, “no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person.” 26 U.S.C. § 7421(a). This restriction can prevent judicial review of a tax before it is collected, but does not affect a plaintiff’s Article III standing to sue.

The Supreme Court has repeatedly held that, with few exceptions not relevant here,²³⁹ federal taxpayers lack Article III standing to challenge the allegedly illegal or even unconstitutional expenditure of federal funds. In *DaimlerChrysler Corp. v. Cuno*, for example, the Court held unanimously that taxpayers lacked Article III standing to challenge a state’s award of preferential tax credits to a local manufacturer.²⁴⁰ As the Court explained in *Frothingham v. Mellon*, a taxpayer’s interest in the federal treasury is indistinct, “minute and indeterminable,” and “the effect upon future taxation, of any payment out of the funds, so remote, fluctuating and uncertain.”²⁴¹ As a consequence, a taxpayer’s alleged injury from the illegal expenditure of federal funds is not “concrete and particularized,” nor is it “actual or imminent.”²⁴²

The logic that precludes taxpayer standing to challenge the allegedly illegal expenditure of taxpayer dollars is “equally applicable” to tax credits and other targeted tax preferences.²⁴³ As Chief Justice Roberts explained for the Court in *Cuno*, a federal taxpayer would lack standing to challenge a tax credit or exemption; “In either case, the alleged injury is based on the asserted effect of the allegedly illegal activity on public revenues, to which the taxpayer contributes.”²⁴⁴ As a consequence, individual taxpayers or even taxpayer organizations would lack standing to challenge the legality of the IRS’ decision to offer tax credits and subsidies to those who purchase health insurance on federally run Exchanges.

²³⁹ These exceptions concern challenges legislative appropriations alleged to violate the First Amendment’s prohibition on the establishment of religion. See, e.g., *Hein v. Freedom from Religion Foundation, Inc.*, ___ U.S. ___ (2007). Whether this exception is coherent or not is another question. See Jonathan H. Adler, *God, Gaia, the Taxpayer and the Lorax: Standing, Justiciability, and Separation of Powers after Massachusetts and Hein*, 20 REGENT UNIVERSITY LAW REVIEW 175 (2008).

²⁴⁰ 547 U.S. 332 (2006).

²⁴¹ 262 U.S. 447, 487 (1923).

²⁴² *Cuno*, 547 U.S. at 344.

²⁴³ *Id.* at 343.

²⁴⁴ *Id.* at 344.

These barriers would not preclude legal challenge to the IRS rule, however. First, the issuance of a tax credit for the purchase of a qualifying health insurance plan in a federal Exchange triggers the penalty for the so-called “employer mandate.”²⁴⁵ Specifically, under Section 1513, when an employee of a company with more than 50 employees receives a tax credit for purchasing insurance on an Exchange, the employer is assessed a penalty of up to \$2,000 per worker.²⁴⁶ If the federal government lacks the legal authority to offer tax credits through a federal Exchange, then any employer that would be penalized as a result of one of those tax credits should have standing to challenge the IRS rule. Such an employer would have to demonstrate that it is covered by the employer mandate; does not provide a qualifying level of health insurance to its employees; and is located in a state that has opted not to create an Exchange. Insofar as the employer-mandate penalty is considered to be a tax, it could be subject to the Anti-Injunction Act, which prevents taxpayers from challenging the legality of a tax before that tax is assessed.²⁴⁷ If so, this would only affect the timing of such a suit, and would not prevent a suitable employer from establishing standing to challenge the rule.

Second, many individuals could be able to challenge the rule on the grounds that the issuance of unauthorized tax credits in federal exchanges exposes them to penalties under the

²⁴⁵ As far as the authors are aware, the first person to make this point was Professor James Blumstein. See, David Hogberg, *Companies Could Challenge ObamaCare Employer Fines*, INVESTOR’S BUSINESS DAILY, Sept. 16, 2011, <http://news.investors.com/article/585053/201109161746/companies-could-challenge-obamacare-employer-fines.htm>.

²⁴⁶ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1513, 124 Stat. 119, 253-256 (2010) as revised by the Health Care and Education Reconciliation Act of 2010.

²⁴⁷ Whether the penalty would be considered a tax for Anti-Injunction Act purposes is not clear. In *NFIB v. Sebelius*, the Court unanimously concluded that the act did not bar suit against the “individual mandate,” even though a majority of the Court upheld the mandate as a tax. *Nat’l Fed’n Indep. Bus. v. Sebelius*, 567 U.S. ___, __ (2012) (“Congress can, of course, describe something as a penalty but direct that it nonetheless be treated as a tax for purposes of the Anti-Injunction Act. For example, 26 U. S. C. §6671(a) provides that “any reference in this title to ‘tax’ imposed by this title shall be deemed also to refer to the penalties and liabilities provided by” subchapter 68B of the Internal Revenue Code. Penalties in subchapter 68B are thus treated as taxes under Title 26, which includes the Anti-Injunction Act. The individual mandate, however, is not in subchapter 68B of the Code.”).

individual mandate. As noted above, the individual mandate exempts non-compliant taxpayers from penalties if their “required contribution” exceeds 8 percent of household income. Under the statute, if a state does not establish an Exchange, the “required contribution” equals the premium for the lowest-cost plan available to the taxpayer through the federal Exchange, because there are no tax credits to reduce the “required contribution” below that premium. If the IRS nevertheless issues unauthorized tax credits through a federal Exchange, then those tax credits could reduce a taxpayer’s “required contribution” below the threshold, exposing her to penalties. In 2016, those penalties can range from \$695 for some individuals to \$2,085 for families of four.

Individuals could establish standing by demonstrating that they live in a state that will not establish an Exchange by 2014; that they would qualify for the affordability exemption in the absence of tax credits; and that the IRS rule would deny them the exemption. To satisfy that last element, individuals would have to show they are between 100 and 400 percent of the federal poverty level; that they will not have “essential” coverage in 2014 (either because they are uninsured or because they purchase less coverage than the mandate requires); and that they do not receive an offer of “essential” and “affordable” coverage from an employer. More than half of uninsured Americans who would be subject to the mandate, or approximately 17.8 million individuals, currently meet those criteria.²⁴⁸ Each is a potential plaintiff, assuming their states do not establish Exchanges. The five states that have most forcefully rejected the idea of establishing an Exchange—Florida, Louisiana, South Carolina, Texas, and Wisconsin—are home to nearly 4.5 million potential plaintiffs. In addition, many insured individuals could establish standing if, for example, they purchase a high-deductible health plan that fails to satisfy the mandate because has an actuarial value below 60 percent.

²⁴⁸ Kaiser Family Foundation, State Health Facts, *Distribution of the Nonelderly Uninsured by Federal Poverty Level (FPL)*, <http://www.statehealthfacts.org/comparetable.jsp?typ=1&ind=136&cat=3&sub=40>.

The Anti-Injunction Act is unlikely to impede a challenge brought by individual taxpayers. The Supreme Court unanimously concluded in *NFIB v. Sebelius* that the individual mandate penalty, while a tax for constitutional purposes, is not a tax for Anti-Injunction Act purposes.²⁴⁹ Thus a challenge brought by individual taxpayers should be able to receive immediate adjudication.

VII. Conclusion

In the end, the IRS rule’s attempt to offer premium-assistance tax credits and cost-sharing subsidies through federal Exchanges lacks validity because the IRS lacks the legal authority to create entitlements where, as here, Congress has not authorized them. Congress has granted the IRS authority to offer premium-assistance tax credits and cost-sharing subsidies only through Exchanges that are “a governmental agency or nonprofit entity that is established by a State.”²⁵⁰ The IRS lacks the authority to offer those entitlements, to enforce the employer mandate, and in many cases to enforce the individual mandate, in states that opt for either a “federally facilitated” Exchange or a “partnership” Exchange.²⁵¹

The Act’s legislative history clearly shows the plain meaning of the statute reflects congressional intent, and offers no evidence to support the counterclaim that the plain meaning of this statute deviates from that intent. The IRS rule neither corrects a scrivener’s error, nor resolves a textual ambiguity, nor resolves an ambiguity regarding congressional intent, because

²⁴⁹ See *NFIB*, at ___.

²⁵⁰ Patient Protection and Affordable Care Act, Pub. L. No. 111-148, Sec. 1311, 124 Stat. 119, 176 (2010).

²⁵¹ Timothy S. Jost, *Implementing Health Reform: A Final Rule On Health Insurance Exchanges*, HEALTH AFFAIRS BLOG, Mar. 13, 2012, <http://healthaffairs.org/blog/2012/03/13/implementing-health-reform-a-final-rule-on-health-insurance-exchanges/>. (The final rule “does clarify that partnership exchanges are in fact federal exchanges and that states must agree to operate both the individual and the SHOP exchange to qualify for state exchange status.”).

there is no ambiguity. There is only a frantic, last-ditch search for ambiguity by supporters who belatedly recognize the PPACA threatens health insurance markets with collapse, which in turn threatens the PPACA. The IRS rule unlawfully usurps Congress' exclusive powers to tax, to create new legal entitlements, to issue tax credits, and to spend federal dollars. Finally, because these unauthorized entitlements would trigger unauthorized penalties against employers and individuals, we find that those employers (including state governments) and individuals could be able to meet the requisite tests for standing and challenge this IRS rule in federal court.

Administrative agencies enjoy wide latitude to interpret and implement federal law. But they cannot rewrite laws to impose taxes, issue tax credits, spend federal revenue, incur new federal debt, or create new legal entitlements without congressional authorization.