Seven Things You Should Know about the IRS Rule Challenged in *King v. Burwell*

And none of them make the IRS look very good

By Michael F. Cannon
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This week, the Supreme Court considers *King v. Burwell*. At issue is whether the IRS exceeded its authority under the Patient Protection and Affordable Care Act by issuing a final IRS rule that expanded the application of the Act's subsidies and mandates beyond the limits imposed by the statute. *King v. Burwell* is not a constitutional challenge. It challenges an IRS rule as being inconsistent with the Act it purports to implement. The case is a straightforward question of statutory interpretation.

Here are seven things everyone needs to know about how the IRS developed the rule at issue in *King v. Burwell*. But first, a little background. If you're familiar with the case, you can skip to number one.

Background

Section 1311 of the Act directs states to establish health-insurance "Exchanges." Section 1321 directs the Secretary of Health and Human Services to establish Exchanges in states that "fail[]" to establish Exchanges. Confounding expectations, 38 states failed to establish Exchanges, in almost every case due to opposition to the Act.

Section 1401 (creating I.R.C. § 36B) authorizes health-insurance subsidies (nominally, tax credits) "through an Exchange established by the State." The availability of those subsidies triggers tax penalties under the law's individual and employer mandates. In January 2014, the IRS began issuing those subsidies and imposing the resulting penalties through not only state-established Exchanges but also Exchanges established by the federal government as well (i.e., HealthCare.gov).

In *King v. Burwell*, the plaintiffs allege that the IRS exceeded its powers under the Act by issuing a so-called final rule that purports to authorize subsidies in states with Exchanges established by the federal government. The plaintiffs claim that the rule and the subsidies being issued in such states are unlawful, because these federal Exchanges are not "established by the State." The plaintiffs claim they are injured because those subsidies trigger also-illegal penalties against them under the Act's individual mandate. (In similar challenges to the same IRS rule, employer-plaintiffs claim injury because those subsidies likewise trigger penalties against them under the Act's employer mandate.)

The government counters that the phrase "an Exchange established by the State" is "a term of art" that includes Exchanges established by the federal government. At a minimum, the government argues, the Act is ambiguous on the precise question at issue, and the IRS's interpretation is reasonable.

In *King v. Burwell*, the government prevailed before both the district court and the Fourth Circuit Court of Appeals. Even though the Fourth Circuit wrote, "The court cannot ignore the common-sense appeal of the plaintiffs' argument; a literal reading of the statute undoubtedly accords more closely with their position," the court deferred to the IRS because it found the statute ambiguous and the IRS's interpretation reasonable.

The government fared less well in other cases challenging the IRS rule. In *Halbig v. Burwell*, the district court found that the Act unambiguously supports the government's interpretation. But a three-judge panel of the D.C. Circuit reversed in a split decision, finding that the Act "unambiguously forecloses" the IRS's interpretation. The full D.C. Circuit agreed to reconsider the panel's ruling, a move that technically vacated the ruling — but not the opinion. In *Pruitt v. Burwell*, the Eastern District of Oklahoma ruled that the IRS rule was "invalid." The D.C. Circuit and Tenth Circuits have put *Halbig* and *Pruitt* aside pending Supreme Court consideration of *King*. The district court for the Southern District of Indiana has not yet issued a ruling in *Indiana v. IRS*, a fourth challenge to the IRS rule, and is likewise waiting to see what the Supremes do with *King*.

Here are seven things you should know about the embattled IRS rule.

1. The IRS's draft rule originally included the statutory language restricting tax credits to Exchanges "established by the State," but IRS officials deleted it and inserted broader language when political appointees approached them about it.

Treasury and IRS officials permitted investigators for two congressional committees to interview officials involved in the formulation of the IRS's tax-credit rule, and to review some (but not all) relevant documents.

The investigators report that in early 2011, Deputy Assistant Treasury Secretary for Tax Policy Emily McMahon read a *Bloomberg BNA* article in which critics discussed how the Act offers tax credits only in states that establish Exchanges. McMahon raised the issue with her colleagues. According to one Treasury Department attorney, McMahon inquired whether this was "a glitch in the law we needed to worry about." Congressional investigators reported what happened next:

An early draft of the 36B proposed rule included the language "Exchange established by the State" in the section entitled "Eligibility for the Premium Tax Credit." Between March 10, 2011, and March 15, 2011, the explicit reference to "Exchanges established by the State" was removed and the phrase "or 1321" was inserted in its place.

The deletion suggests IRS officials knew this language posed an obstacle to offering tax credits in federal Exchanges. If it didn't, there would have been no reason to delete it.

2. IRS officials knew the statute did not authorize them to issue tax credits in federal Exchanges, but they decided to issue them anyway for political reasons.

The investigators found additional evidence that Treasury and IRS officials knew they had no statutory authority to issue tax credits in federal Exchanges.

IRS officials recognized that what they wanted to find in the statute simply wasn't there. In a March 25, 2011, e-mail, Treasury and IRS officials described the lack of authorization for subsidies in federal Exchanges as a "drafting oversight."

IRS officials also recognized the "apparently plain" language limiting tax credits to state-established Exchanges. Investigators found that a draft of the final rule contained a discussion of this issue that "stated that agencies have broad discretion to reasonably interpret a [law] if the ‘apparently plain statutory language’ is inconsistent with the purpose of the law.” Agency officials dropped that discussion from the final rule shortly before issuing it.

IRS officials chose to issue tax credits in federal Exchanges “because they concluded this was required for the new health-care initiative to succeed,” the *Washington Post* reported. “And, the officials reasoned, Congress would not have passed a law that it wanted to fail.”

In other words, IRS officials did not do their job, which is to implement the law according to the terms spelled out by Congress. Instead, they knowingly disregarded the “apparently plain” statutory text in pursuit of the political goal of helping the law succeed.

3. The IRS performed little or no analysis of the statute or legislative history, and it failed to consider important dimensions of the issue.

Investigators found that the IRS never considered that the ACA’s authors had a clear preference for state-run Exchanges; or that Congress might have conditioned tax credits on states’ establishing Exchanges as a way of motivating states to implement this part of the law; or that a leading health-law scholar proposed conditioning premium subsidies on states’ establishing Exchanges in early 2009; or that another leading Senate bill also conditioned Exchange subsidies on state cooperation; or that House Democrats complained that states that refused to establish Exchanges would prevent their residents from receiving “any benefit” from the ACA. Finally, IRS officials were not able to produce any written record showing they actually researched the ACA’s legislative history.

Agency officials did admit that, in attempting to ascertain Congress’s intent, they relied on statements House members made about the House bill. Such statements are irrelevant, of course, because they pertain to a different bill: one with different language than the ACA, one that explicitly did authorize subsidies in state-run Exchanges, and one that did not and *could not have* passed Congress.

4. The IRS offered almost no explanation for its decision.

The IRS announced its decision to issue subsidies in federal Exchanges when it released its proposed rule in August 2011. The proposed rule contained no explanation for this departure from the statute.

Congressional investigators found that "the only written analysis produced by Treasury and IRS regarding the availability of premium subsidies in federal exchanges before the proposed rule was issued" was a one-paragraph explanation for the IRS's decision buried in a March 2011 memorandum from the IRS's Chief Counsel's Office that the agency never made public.

The only public explanation the IRS offered for its interpretation prior to issuing the final rule came in a November 2011 letter to members of Congress who claimed that the IRS was exceeding its authority:

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 [E]xchange.

When the IRS issued its final rule in May 2012, it offered only this one-paragraph, non-substantive explanation:

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.

This paragraph from the final rule, which constitutes the agency's entire explanation for its decision in the administrative record, identifies neither the "statutory language," nor the "language, purpose, and structure" of section 36B and the Act, nor the "relevant" legislative history, upon which the agency supposedly relied in taking this action. Indeed, the agency carefully avoids saying either that the Act plainly authorizes tax credits in federal Exchanges, or that the Act is ambiguous on this question.

5. The IRS waited five months after the final rule was issued, and after it had been challenged in court, before identifying any supposed statutory support.

The first time the IRS even cited part of the Act in support of its decision was in an October 2012 response to the chairman of the House Oversight committee. Assistant Treasury Secretary Mark Mazur claimed that the Act's language contained "no discernible pattern that suggests Congress intended the particular language of section 36B(b)(2)(A) to limit the availability of the tax credit."

Then again, as discussed above, the IRS made no discernible effort to check. The evidence is right there in Mazur's own words. He mentions only section 36B(b)(2)(A) and ignores (or is unaware) that section 36B also contains a second explicit passage and seven cross-references limiting tax-credit eligibility to those who enroll in coverage "through an Exchange established by the State."

6. The deletion of "established by the State" from the proposed rule and the insertion of "or 1321" contradict two separate arguments the government offers before the Supreme Court — and reveal those arguments to be post-hoc rationalizations.

The government now claims the phrase "Exchange established by the State" is a statutory "term of art" that poses no obstacle to issuing tax credits in federally established Exchanges. But if that were true, there would have been no reason for the IRS to delete that phrase from the proposed rule.

The government also argues before the Supreme Court that Section 1321 Exchanges are *by definition* Section 1311 Exchanges. But if that were true, there would have been no reason for the IRS to list the two types of Exchanges separately in the proposed rule. Alternatively, having listed both, the IRS should have explained that federal Exchanges are, technically, Section 1311 Exchanges. But it didn't.

Indeed, it is clear that at the time, the administration saw state-established and federal Exchanges as distinct. In March 2012, between the issuance of the proposed and final IRS rules, the Department of Health and Human Services issued a regulation explaining that a "federally-facilitated Exchange" is "an Exchange established and operated within a State by the Secretary under section 1321(c)(1) of the Affordable Care Act."

The fact that these arguments are not only absent from but also contradicted by the administrative record shows that they are post-hoc rationalizations for the IRS's decision. And poor ones, at that.

7. IRS officials tried to hide their reasoning from the public.

This week, the *Washington Post* reported that as critics began to scrutinize the IRS's departure from the apparently plain language of the statute, the agency sought to hide its reasoning and avoid drawing attention to its decision:

The Treasury and IRS team writing the regulations recognized that the environment was becoming highly charged. . . . Discussions intensified inside Treasury and the IRS over how to show that the government had considered the opponents' views but not draw media attention to the debate over subsidies, former officials recalled. "The overriding concern was not generating negative news stories," one former official said.

That concern appears to have prevailed over reasoned decision-making and accountability.

And it continues to do so: To this day, the Treasury Department and IRS are ignoring a congressional subpoena of documents related to development of the IRS's tax-credit rule.

So where does all this leave us?

The available evidence shows that the IRS developed the challenged regulation knowing that Congress had expressly denied the agency the authority to implement the challenged taxes and subsidies and penalties. The IRS initially drafted regulations incorporating that limitation on its authority but then reversed itself after receiving input from political appointees at the Treasury Department. The purpose of that reversal was not to effectuate Congress's "apparently plain" intent, but to subvert it. The IRS has consistently tried to shield its decision and its reasoning from public scrutiny. And the government's defenses of the IRS rule are post-hoc rationalizations.

Keep that in mind while you're enjoying the public debate over *King v. Burwell*.

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