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The IRS Has Gone Rogue

By Michael F. Cannon & Jonathan H. Adler
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A president who says "I haven't raised taxes" has authorized his Internal Revenue Service issue a "final rule" that will illegally tax some 12 million individuals, plus large employers, in as many as 40 states beginning in 2014. Oklahoma's attorney general has asked a federal court to block this rule. Members of Congress have introduced legislation in both the House and the Senate to quash it.

At first glance, it might not seem that the IRS is up to anything nefarious. The rule in question concerns the Patient Protection and Affordable Care Act's tax *credits*, not the law's tax increases. The tax credits are intended to offset the cost of insurance premiums for low- and middle-income workers.

For many Americans, however, those tax credits are like an anchor disguised as a life vest. The mere fact that a taxpayer is *eligible* for a tax credit can trigger tax liabilities against both the taxpayer (under the act's "individual mandate") and her employer (under the "employer mandate"). In 2016, these tax credits will trigger a tax of $2,085 on many families of four earning as little as $24,000. An employer with 100 workers could face a tax of $140,000 if even one of his workers is eligible for a tax credit.

So it is significant that the PPACA explicitly and repeatedly restricts eligibility for tax credits to people who purchase health insurance "through an Exchange [i.e., government agency] established by the state" in which they live. That means that under the statute Congress enacted, a state can block those hefty taxes simply by declining to create an exchange. The PPACA directs the federal government to create an exchange in any state that declines to create one itself, and Health and Human Services secretary Kathleen Sebelius estimates she may have to do so in as many as 30 states. (Some experts put the number closer to 40.) However, because the statute withholds tax credits in federal exchanges, the creation of a federal exchange does not trigger tax liabilities. By our count, as many as 12 million low- and middle-income Americans would be exempt from those taxes, including 250,000 Oklahomans.

It is here that the IRS has gone rogue. The agency has announced that, despite the clear statutory language restricting tax credits to exchanges established by states, it will issue tax credits through *federal* exchanges. One can see why Oklahoma and the rest might be upset: By offering tax credits in states that opt not to create exchanges, the IRS is imposing taxes where Congress did not authorize them. This IRS rule will tax those 12 million low- and middle-income Americans, including 250,000 Oklahomans, contrary to the express language of the PPACA.

Defenders of the rule claim that Congress intended the tax credits to be available in all exchanges. But is that true?

It may come as a surprise to supporters of the PPACA, as it did to us, but all the evidence that has surfaced to date shows that Congress restricted and, yes, intended to restrict tax credits to state-created exchanges. What the IRS is doing is illegal.

We examine the evidence in our forthcoming *Health Matrix* article, "Taxation Without Representation: The Illegal IRS Rule to Expand Tax Credits Under the PPACA." Here are a few highlights, including some material that is not included in our article.

1. The text of the PPACA is unambiguous.

The Supreme Court explained in *Connecticut National Bank v. Germain* that when a court is trying to divine congressional intent, the most important factor is the text of the statute:

> In interpreting a statute a court should always turn first to one cardinal canon before all others. We have stated time and again that

> courts must presume that a legislature says in a statute what it means and means in a statute what it says there. . . . When the words of a statute are unambiguous, then, this first canon is also the last: judicial inquiry is complete.

Using that canon as its guide, the Congressional Research Service writes this about the text of the PPACA's tax-credit provisions:

> 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.

Not convinced? You're not alone. The CRS explained that courts might uphold the IRS rule if they were "willing to engage in a searching statutory interpretation involving text, context, legislative purpose, and legislative history." So let's look at context, legislative purpose, and legislative history.

2. Every health-care overhaul advanced by Senate Democrats denied premium assistance to residents of non-compliant states.

The PPACA's language restricting tax credits to state-created exchanges came almost verbatim from a bill reported by the Senate Finance Committee.

Senate Democrats' other leading health-care bill emerged from the Health, Education, Labor, and Pensions Committee. The HELP bill allowed premium assistance through federal exchanges (called "gateways") in certain circumstances. But if a state refused to assist with implementation, the HELP bill denied premium-assistance subsidies to that state's residents. And if a state fell out of compliance, the HELP bill explicitly revoked these subsidies from residents who were already receiving them.

Harsh? Perhaps. But this legislative history shows that denying premium assistance to residents of non-compliant states was not some beyond-the-pale idea that Congress could not possibly have intended, but was instead the dominant approach in the Senate; *every* bill Senate Democrats advanced contained this feature. The HELP bill also suggests a legislative purpose behind the language: to encourage states to implement the law.

3. During Senate consideration, the PPACA's lead author admitted that the bill made tax credits conditional on state compliance.

Finance Committee chairman Max Baucus (D., Mont.) was the chief sponsor and lead author of the Finance bill. He shepherded it through committee consideration and through negotiations with Obama-administration officials and congressional leaders, and he can reasonably claim to be the man most responsible for the relevant language of the PPACA.

During a September 23, 2009, committee markup of his bill, Baucus acknowledged that restricting tax credits to policies purchased through state-created exchanges was the reason the Finance Committee had jurisdiction to direct states to establish exchanges, making this language an essential part of the bill. (Again, the Finance bill's language restricting premium assistance to state-created exchanges was adopted without substantive change in the PPACA.) The admission came amid a debate over the committee's jurisdiction. Baucus had ruled an amendment dealing with medical malpractice out of order on the grounds that the Finance Committee did not have jurisdiction to legislate in that area. Sensing a double standard, Senator John Ensign (R., Nev.) challenged Baucus. The Finance Committee, Ensign said, did not have jurisdiction to direct states to change their laws regarding health-insurance coverage or to establish exchanges — such matters fall within the jurisdiction of the HELP Committee — yet the Baucus bill did both. If the Finance Committee could not consider a medical-malpractice amendment, Ensign asked, then how could it direct states to create exchanges? For Baucus's response, we go to the tape:

http://www.youtube.com/watch?v=lC3lxb2WBYo

Baucus responded that the Finance Committee had jurisdiction because his bill offered tax credits to individuals on the condition that their states complied with the bill's health-insurance provisions: "Taxes are in the jurisdiction of this committee"; "An exchange is essentially [where individuals can access] tax credits": "There are conditions to participate in the exchange." To place "conditions" on tax credits, of course, presumes a scenario in which they are not available.

It is worth mentioning that this is the only bit of context or legislative history that anyone has found that directly addresses the question of whether the PPACA authorizes tax credits in federal exchanges. And it highlights an additional legislative purpose that is important enough to count separately.

4. Restricting tax credits to state-created exchanges was an essential feature of the bill.

The conditional nature of the tax credits is what gave the Finance Committee a jurisdictional hook to legislate in this area. The need for that hook may have disappeared when the bill reached the Senate floor. But the language restricting tax credits to state-run exchanges did not.

5. House Democrats knew the Senate bill empowered states to block residents from "receiv[ing] any benefit."

By early January 2010, Democrats were trying to iron out a compromise between the House and Senate bills that could clear both chambers. On January 11, eleven House Democrats from the Texas delegation sent a letter to President Obama, House Speaker Nancy Pelosi (D., Calif.), and House Majority Leader Steny Hoyer (D., Md.). They demanded "a single, national health insurance exchange, as adopted by the House," rather than the Senate bill's "weak, state-based health insurance exchanges." The Senate bill "relies" on states to implement exchanges, they warned, even though "a number of states opposed to health reform have already expressed an interest in obstruction."

To emphasize the dangers of the Senate bill, they noted that Texas officials had recently turned down health-care subsidies that Congress had made available under another law. As a result, they wrote, not a single Texas resident "has yet received any benefit" from that law. "The Senate approach," they wrote, "would produce the same result — millions of people will be left no better off than before Congress acted."

The Texas Democrats made no explicit mention of how the Senate bill restricted tax credits to states that created their own exchanges, yet they clearly saw a difference between state-created and federal exchanges under the Senate bill — a difference that would leave people in recalcitrant states without the assistance that residents of compliant states would receive.

So far, we've got the following context pointing to the conclusion that the IRS's decision to offer tax credits through federal exchanges violates congressional intent: (1) the unambiguous text of the statute, (2) evidence that making tax credits conditional on state compliance was the dominant approach in the Senate, (3) an affirmation by the law's primary author that the Finance bill's language was deliberate and (4) essential, and (5) evidence that House Democrats understood the Senate bill would withhold benefits from non-compliant states. But even if we didn't have items (2) through (5) . . .

6. By enacting the PPACA, supporters revealed that their true intent was to enact whatever the Senate bill contained.

On January 19, 2010 — eight days after the Texas Democrats' letter — Massachusetts voters elected Republican Scott Brown to the Senate, in part because of his pledge to be the 41st vote Senate Republicans needed to filibuster any compromise health-care bill. On that day, Massachusetts voters killed the House bill and its approach to exchanges, leaving House Democrats with only two options: Either they could pass the Senate bill and hope to obtain limited amendments through the "reconciliation" process, or they would fail to pass a bill at all. When House Democrats approved the PPACA, they revealed that their intent was to restrict tax credits to state-created exchanges, because they preferred that option to failure. They decided that whatever the Senate bill's approach to premium assistance, it was better than no premium assistance at all.

If federal courts do enough searching, they will surely find lots of PPACA supporters who wanted subsidies in federal exchanges, just as lots of them wanted a "public option." But those possibilities died the day Massachusetts voters sent Scott Brown to the Senate. No matter what else PPACA supporters may have *wanted* to enact, their approval of the Senate language reveals they *intended* to restrict tax credits to state-created exchanges. If offering premium assistance through federal exchanges had been their intent, they would have put the House bill up for a vote in the Senate, rather than the other way around.

The text, context, legislative purpose, and legislative history of the PPACA all demonstrate that Congress did not intend to offer tax credits — nor to tax the aforementioned individuals and employers to help cover that cost — in states that declined to create exchanges. Evidence that the IRS's disputed final rule violates the law *and* congressional intent has been mounting ever since we brought attention to this issue last year. It has continued to mount even since we wrote in June, "The IRS doesn't have a leg to stand on here." This mounting evidence has forced supporters of the rule to change their story a number of times, yet their new and improved defenses of the rule are inadequate and even self-contradictory. The IRS has gone rogue, taxing individuals and employers without statutory authority, and it deserves a swift rebuke from the federal courts.

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