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King v. Burwell: Supreme Court Rules that ACA Tax Subsidies Are Available Through Federal Exchanges

The U.S. Supreme Court has issued its decision in *King v. Burwell*, holding – by a vote of 6 to 3 – that the Affordable Care Act ("ACA") does **allow** the payment of tax credits to subsidize the cost of health insurance coverage for low-income individuals who purchase coverage through an Exchange operated by the federal government. Chief Justice Roberts authored the opinion, which was joined by Justices Kennedy, Ginsburg, Breyer, Sotomayor and Kagan. Justices Scalia, Thomas and Alito dissented.

The holding significantly impacts many stakeholders in the health care industry, including (1) health insurers, to whom the subsidies are paid, (2) employers, given that the ACA's "employer mandate" penalty is only triggered if a full-time employee receives a federal tax credit, and (3) individuals who were at risk of losing access to federal premium subsidies. The Court's ruling is critically important to the implementation of the ACA, given that 34 states have declined to establish Exchanges.

Below is a high-level overview of the *King* case, the Court's ruling, and its impact on insurers, employers and individuals.

Background

A. ACA Provisions Concerning Payment of Tax Credits

Section 1311 of the ACA provides that individuals can purchase health insurance on American Health Benefit Exchanges ("Exchanges"). Under the ACA, Exchanges may be established by either individual states or the federal government. Congress expected most states to establish their own Exchanges and provided financial assistance to enable states to do so. But Congress also realized that some states might refuse to establish Exchanges. For that reason, Section 1321(c) of the ACA provides that if a state declines to establish its own Exchange, the federal Department of Health and Human Services ("HHS") "shall establish and operate such Exchange within the State[.]"

The ACA also authorizes a federal tax credit for low- and middle-income individuals who purchase insurance through an Exchange "established by a State."[1] Specifically, the ACA added Section 36B to the Internal Revenue Code (the "Code"), which provides that tax credits are available to otherwise qualifying individuals who "were enrolled in [coverage] through an Exchange *established by the State* under [section] 1311 of the [ACA]." (Emphasis added). This italicized language raised the question of whether tax subsidies would be

[1] Generally, premium tax credits and cost-sharing reductions are available to individuals whose household income is between 133-400 percent of the Federal Poverty Level. Code § 36B(b).

available only for coverage that was purchased through a state-established Exchange, and preclude the payment of subsidies for coverage obtained through a federal Exchange. This question became even more critical once the Exchanges began operating, given that only 16 states plus the District of Columbia initially established their own Exchanges.

The Internal Revenue Service ("IRS") issued a regulation interpreting Code Section 36B to allow for the payment of tax credits to all otherwise eligible Americans, regardless of whether they purchased coverage through a state or federal Exchange. In reaching this conclusion, the IRS took the view that the ACA's mandate that HHS "establish *such* Exchange" when a state declines to do so essentially placed HHS in the shoes of the state, thus allowing for the payment of tax credits to otherwise qualifying individuals who obtained coverage through a federally-established Exchange.

B. Federal Courts Disagreed on the Meaning of the ACA Provisions

A number of lawsuits were filed challenging the IRS's interpretation. The plaintiffs in *King* filed a lawsuit in the Eastern District of Virginia, arguing that the IRS's interpretation was contrary to Code Section 36B, which limits the availability of tax credits to only coverage obtained through an Exchange "established *by a State*." Because a federal Exchange is not "established by a State," the plaintiffs argued, the plain language of the Code Section 36B prohibited the payment of tax credits for coverage obtained through a federal Exchange. Additionally, the plaintiffs argued that the purpose of the tax credit was to induce states to set up their own Exchanges, by providing that the credit would not be available if the federal government had to operate the Exchange. The district court in *King* rejected the plaintiffs' arguments and granted the government's motion to dismiss the case.

A similar lawsuit, *Halbig v. Burwell*, was filed in the federal court of the District of Columbia. And like the district court in *King*, the DC-based district court ruled in favor of the government, finding that its interpretation of Code Section 36B was reasonable given ambiguities in the statutory language. Several similar cases are pending in other courts across the country.

On July 22, 2014, the Fourth Circuit Court of Appeals upheld the district court's ruling in *King v. Burwell.* In so doing, the appellate court upheld the IRS regulation providing that federal premium subsidies are available to individuals purchasing health insurance through the federal Exchanges. The Fourth Circuit found that the IRS's interpretation was a "permissible exercise of the agency's discretion." But on the same day, a contrary decision was issued by the Court of Appeals for the DC Circuit in *Halbig v. Burwell*. In a 2-1 ruling, the DC Circuit found that the IRS's interpretation was contrary to the plain language of Code Section 36B, and that the agency's interpretation was therefore impermissible.

The Supreme Court agreed to hear the plaintiffs' appeal in the *King* case. It is important to note that unlike the Supreme Court's 2012 decision in *National Federation of Independent Business v. Sebelius* – which addressed whether the ACA's "individual mandate" was constitutional (and which, in turn, could have resulted in the invalidation of the ACA entirely) – the *King* case involved a matter of statutory interpretation that technically impacts only one provision of the ACA, *i.e.*, whether Code Section 36B's reference to Exchanges "established by the State" precludes payment of subsidies for coverage obtained through a federally-established Exchange. In other words, a ruling against the government in the *King* case would not invalidate the ACA in its entirety. But as discussed below, the Court's decision in *King* has significant consequences for health insurers and employers, as well as individuals who live in the 34 states where the federal government operates Exchanges in lieu of the respective states.

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The Court's Ruling

Chief Justice Roberts wrote the opinion for the Court, holding that premium subsidies are available for coverage obtained through a federal Exchange, notwithstanding the language of Code Section 36B, which provides that subsidies are available for coverage obtained through an Exchange "established *by the State*." The Court noted that the petitioners' arguments about the plain meaning of the Code Section 36B are "strong," but nevertheless found that the phrase "established by the State" is properly viewed as ambiguous. According to the Court, "the phrase may be limited in its reach to State Exchanges. But it is also possible that the phrase refers to *all* Exchanges—both State and Federal—at least for purposes of the tax credits." (Slip Op. at 12-13).

A. *Chevron* Deference Does *Not* Apply

The Court began its analysis by noting that when an agency interprets an ambiguous statute, the traditional approach for judicial review – articulated in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) – is for the court to assess whether the agency's interpretation of the ambiguous language is reasonable, and, if so, to then defer to the agency's interpretation. But the Court in *King* found that notwithstanding the ambiguity of the phrase "established by the State," the *Chevron* approach was *not* applicable because the availability of subsidies in federal Exchange states is a "question of deep economic and political significance that is central to [the ACA's] statutory scheme; had Congress wished to assign that question to an agency, it surely would have done so expressly. It is especially unlikely that Congress would have delegated the decision to the *IRS*, which has no expertise in crafting health insurance policy of this sort." (Slip Op. at 8, italics in original). Accordingly, the Court took it upon itself to resolve the ambiguity, rather than deferring to the IRS's interpretation.

B. The Phrase "Established By the State," When Read In Context, Indicates that State and Federal Exchanges Are Equivalent

To determine what Congress intended by the phrase an "Exchange established by the State," the Court read those words "in their context and with a view to their place in the overall [ACA] scheme," finding that the Court's duty is to "construe statutes, not isolated provisions." *Id.* at 9. Reading the language of Code Section 36B, the Court found that for subsidies to be available, three things must be true: "First, the individual must enroll in an insurance plan through 'an Exchange.' Second, that Exchange must be 'established by the State.' And third, that Exchange must be established "under [42 U. S. C. §18031]."

The Court held that there was no dispute that a federal Exchange qualified as an "Exchange" within the meaning of the ACA, thus satisfying the first part of the test. As for the second and third prongs, the Court found that although the statutory language was ambiguous, the role of federal Exchanges when read in the context of the ACA as a whole indicated that Congress viewed federal Exchanges as equivalent to state Exchanges. Significant to this conclusion is the ACA's mandate that HHS "establish *such* Exchange" when a state declines to do so. According to the Court, "By using the phrase 'such Exchange,' [the ACA] instructs [HHS] to establish and operate the *same* Exchange that the State was directed to establish[.]" *Id.* at 10 (emphasis in original). Indeed, "by using the phrase 'such Exchange,' the [ACA] indicates that State and Federal Exchanges should be the same. But State and Federal Exchanges would differ in a fundamental way if tax credits were available only on State Exchanges—one type of Exchange would help make insurance more affordable by providing billions of dollars to the States' citizens; the [federal] Exchange would not." *Id.* at 13. In support of this conclusion, the Court noted other provisions of the ACA require all Exchanges, whether state or federal, to provide information to consumers about premium tax credits and to report (to the IRS) the amount of premium tax credits that consumers received, which the Court held "would make little sense" if tax credits were not available on federal Exchanges. *Id.* at 14.

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C. The ACA As a Whole Indicates that Tax Subsidies Must Be Available Through Both State and Federal Exchanges

The Court then looked to the broader structure of the ACA to determine the meaning of Section 36B. In so doing, the Court held that "the [ACA's] statutory scheme compels us to reject the petitioners' [narrow] interpretation because it would destabilize the individual insurance market in any State with a Federal Exchange, and likely create the very 'death spirals' that Congress designed the Act to avoid." *Id.* at 15. This is because the ACA's three major reforms—guaranteed issue/community rating, the individual mandate, and the availability of tax credits to subsidize the cost of insurance coverage—could not work together in the 34 federal Exchange states if the tax subsidies were unavailable. According to the Court, the unavailability of tax credits in federal Exchange states would result in a drop in the number of people with insurance, which "could well push a State's individual insurance market into a death spiral. . . . It is implausible that Congress meant the [ACA] to operate in this matter." *Id.* at 17. The Court further noted that Congress made the guaranteed issue and community rating requirements applicable to every state, but found "those requirements only work when combined with the coverage requirement and the tax credits. So it stands to reason that Congress meant for these provisions to apply in every State as well." *Id.* at 17-18.

The Court ended its analysis by finding that the language of Section 36B defines an "applicable taxpayer" who is eligible for a subsidy "as anyone in the specified income range," without regard to whether they purchased their coverage through a state or federal Exchange. According to the Court, had Congress intended to limit tax credits to just state Exchanges, it would have done so in the definition of an "applicable taxpayer" or in some other *prominent* manner, such that individuals and states would be on notice that subsidies would not be available through federal Exchanges. *Id.* at 19-20.

Justice Roberts ended his opinion by stating that "Congress passed the [ACA] to improve health insurance markets, not to destroy them. If at all possible, we must interpret the Act in a way that is consistent with the former, and avoids the latter. Section 36B can fairly be read consistent with what we see as Congress's plan, and that is the reading we adopt." *Id*. at 21.

The Dissent

Justice Scalia, joined by Justices Thomas and Alito, argued that the majority's reading of the statutory provision at issue was "absurd," given that "The Secretary of Health and Human Services is not a State. So an Exchange established by the Secretary is not an Exchange established by a State—which means people who buy health insurance through such an Exchange get no money under [Section] 36B." Dissent, Slip. Op. at 1-2.

The dissent agreed that interpreting a statute requires reading the words of any provision in context, but argued that principles of statutory construction presume that lawmakers use words in their natural and ordinary way and that "saying that an Exchange established by the Federal Government is 'established by the State' goes beyond giving words bizarre meanings; it leaves the limiting phrase 'by the State' with no operative effect at all. This is a stark violation of the elementary principle that requires an interpreter to give effect, if possible, to every clause and every word of a statute." *Id.* at 4-5.

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As for the mandate that HHS establish "such" Exchange when a state declines to do so, the dissent argued that "Even if it were true the term 'such Exchange' . . . implies that the federal and state Exchanges are the same in general, the term 'established by the State' in [Section] 36B makes plain that they differ when it comes to tax credits in particular." *Id.* at 8. With respect to provisions of the ACA that would require federal Exchanges to provide consumers with information about (unavailable) tax credits—and to file reports with the IRS about them—the dissent argued "Laws often include unusual or mismatched provisions. The [ACA] spans 900 pages; it would be amazing if its provisions all lined up perfectly with each other. This Court does not revise legislation just because the text creates an apparent anomaly." *Id.* at 9.

In response to the majority's reliance on the interlocking nature of the ACA's guaranteed issue/community rating, individual mandate and tax credit reforms, the dissent argued that statutory design and purpose matter only to the extent they help clarify an otherwise ambiguous provision. The dissenters also pointed out that the ACA established a long-term care insurance scheme with community rating and guaranteed issue requirements – but no individual mandate – which was later repealed because actuarial analyses revealed the program to be fiscally unsustainable. According to the dissenters, this was evidence that Congress did not view the ACA's guaranteed issue and individual mandate reforms as inextricably linked to the availability of tax subsidies in all states. *Id.* at 13-14.

The dissent concluded by criticizing the majority's "somersaults of statutory interpretation," and suggested that the law be renamed "SCOTUS Care," given the extent to which the Court has rewritten the law.

Implications of the Ruling

Because the Supreme Court has upheld the federal government's position and the ruling of the Fourth Circuit in *King*, qualifying individuals remain eligible for premium subsidies regardless of whether they obtain coverage through a state or federal Exchange. The Obama Administration estimates that that approximately 7 million people currently receive subsidized coverage in federal Exchange states.

The Court's decision is also critically important to insurers. Insurers that offer qualified health plans in federally-run Exchange states will continue to have at least part of their premiums for coverage issued to low-income individuals paid by the federal government. This may assist in mitigating premium increases in future years, given that the subsidies help encourage younger and healthier people to purchase insurance, which, in turn, offsets some of the adverse risk that insurers have had to take on following the implementation of the ACA's market reforms (such as guaranteed issue and renewability of coverage).

The Court's decision also impacts large employers in the 34 states where the federal government runs the Exchange, given that the ACA's "employer mandate" will go into effect in those states as scheduled.[2] The employer mandate penalty kicks in when a full-time employee receives a federal subsidy for coverage purchased through an Exchange. Now that the Court has definitively ruled that individuals in federal Exchange states are eligible for subsidies, it follows that large employers in those states will be liable for the penalty if their full-time employees qualify for subsidized coverage through a federal Exchange. (Note, however, that subsidies generally are not available for

[2] Section 4980H of the Code requires "large" employers – *i.e.*, those that employed an average of at least 50 full-time and full-time equivalent employees during the prior calendar year – to pay an excise tax in the event that (1) the employer fails to provide minimum essential coverage to "substantially all" full-time employees (and their dependents) that is affordable and provides minimum value, and (2) at least one of these employees receives a federal premium tax credit or cost-sharing subsidy for coverage on either a state or federal Exchange.

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employees who are eligible for employer-sponsored coverage, if the coverage offered meets certain affordability and minimum value thresholds).[3]

Employers are well-advised to continue to focus on ACA implementation. The Court's ruling means that all ACA provisions remain in effect, including, for example, the extensive reporting requirements and employer mandate requirements which will apply equally in both state- and federally-run Exchange states. In addition, employers will need to continue to analyze the possible effect of the 40-percent excise tax on high cost plans (the so-called "Cadillac Tax") that will take effect beginning in 2018.

[3] As noted above, premium tax credits and cost-sharing reductions generally are available to individuals whose household income is between 133-400 percent of the Federal Poverty Level. That said, if an individual who satisfies this income criteria has been offered minimum essential coverage by his or her employer, he or she will *ineligible* for federally subsidized coverage on the Exchange. *See* 26 CFR § 1.36B(2)(a). There is an exception, however: if the employer's offer of coverage is either (1) unaffordable (*i.e.*, the cost of self-only coverage is more than 9.5 percent of income) or (2) does not provide minimum value (*i.e.*, does not have an actuarial value of at least 60 percent), an employee who declines such coverage may qualify for the federal subsidy if he or she is income eligible. *Id.*

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