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Oversight of IRS's Legal Basis for Expanding ObamaCare's Taxes and Subsidies

Subcommittee on Energy Policy, Health Care and Entitlements
Committee on Oversight and Government Reform
U.S. House of Representatives

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Mr. Chairman and members of this subcommittee, thank you for the opportunity to present testimony on the Internal Revenue Service rule purporting to extend the availability of tax credits and subsidies for the purchase of health insurance in federal exchanges under the Patient Protection and Affordable Care Act (PPACA), aka "ObamaCare."

By way of background, I am the inaugural Johan Verheij Memorial Professor of Law and Director of the Center for Business Law and Regulation at the Case Western Reserve University School of Law, where I teach courses on administrative and constitutional law, among other subjects. I particularly appreciate the opportunity to appear before this subcommittee given my extensive work on this issue, including the law review article I co-authored with Michael Cannon.[1] I will draw upon this article in my testimony today.

This subcommittee has asked for my views on the legal basis for the IRS and Treasury Department rule purporting to extend the availability of tax credits and cost-sharing subsidies to federal exchanges. My conclusion is simple: There is none. The IRS rule is directly contrary to the plain language of the PPACA and is not otherwise authorized by this or any other statute. With this rule, the IRS has usurped the legislature's role and assumed for itself the power to authorize tax credits and federal spending, as well as to trigger the imposition of penalties on employers and shift the incidence of the individual mandate tax penalty. Even worse, it appears that the IRS promulgated this rule without adequately considering the relevant statutory language or otherwise engaging in reasoned decision-making.

The PPACA

One of the central features of the PPACA is the creation of state-based health insurance exchanges, government-managed marketplaces in which consumers can shop for health insurance plans. Specifically, Section 1311 of the Act calls for each state to create its own "American Health Benefit Exchange" that will facilitate the purchase and regulation of qualified health insurance plans.[2] Section 1311's requirement that states create exchanges is not enforceable, however, as the federal government may not commandeer state governments to implement a federal regulatory scheme.[3] Rather, the federal government must give states a choice whether to cooperate. The federal government may offer various inducements for state cooperation, such as financial support or regulatory consequences, but states must be left with a meaningful choice.[4]

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[1] *See* Jonathan H. Adler and Michael F. Cannon, *Taxation without Representation: The Illegal IRS Rule to Expand Tax Credits under the PPACA*, 23 HEALTH MATRIX 119 (2013).

[2] 42 U.S.C. § 18031(b)(1).

[3] *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, 162 (1992) ("the Constitution has never been understood to confer upon Congress the ability to require States to govern according to Congress's instructions"). For a brief discussion of this principle in the context of health care reform, see Jonathan H. Adler, *Cooperation, Commandeering, or Crowding Out: Federal Intervention and State Choices in Health Care Policy*, 20 KANSAS JOURNAL OF LAW & PUBLIC POLICY 199, 208-09 (2011).

[4] *See* National Federation of Independent Business v. Sebelius, 132 S.Ct. 2566, 2602 (2012) ("Congress may use its spending power to create incentives for States to act in accordance with federal policies. But when 'pressure turns into compulsion,' the legislation runs contrary to our system of federalism." (citation omitted)).

Despite the obligatory language of Section 1311, the PPACA gives states a choice of whether to take responsibility for (and bear the cost of) operating an Exchange. States that agree to set up an exchange are eligible for start up funds from the federal government. In addition, other provisions of the PPACA provide tax credits and cost-sharing subsidies to assist low-income residents of such states in purchasing qualified health insurance plans. Specifically, the Act offers refundable "premium assistance" tax credits to households with incomes between 100 and 400 percent of the federal poverty level (FPL).[5] These tax credits are refundable, which means that if the credit is larger than a taxpayer's tax obligations, the taxpayer is eligible for a payment from the Treasury. The Act further offers "cost-sharing" subsidies to help low-income individuals and families obtain more than the minimum level of coverage at no additional cost. Should a state refuse to create its own exchange, Section 1321 provides that the federal government is to create an Exchange in the state's stead.[6] In this respect, the PPACA embodies the sort of "cooperative federalism" common in many federal programs, from environmental regulation to Medicaid.[7]

As written, the PPACA only provides for the issuance of tax credits for the purchase of qualifying health insurance plans in Exchanges established by states under Section 1311 of the Act. The PPACA is quite clear on this point. The tax credits for the purchase of qualifying health insurance plans are provided for under Section 1401 of the PPACA, which creates a new section of the Internal Revenue Code – Section 36B.[8] This provision authorizes tax credits for each month in a given year in which a taxpayer has obtained qualifying health insurance through a state-run exchange. As defined by Section 1401, a "coverage month" is any month in which the taxpayer is "covered by a qualified health plan . . . that was enrolled in through an Exchange *established by the State under section 1311*."[9] The amount of the tax credit is also calculated with reference to a qualifying health insurance plan "enrolled in through an Exchange established by the State under [Section] 1311 of the Patient Protection and Affordable Care Act."[10] Section 1311 further establishes the "requirement" that an "Exchange" be "a government agency or nonprofit entity that is established by a State."[11] To further erase any doubt, Section 1304 of the PPACA also defines "State" as "each of the 50 states and the District of Columbia."[12] The cost-sharing subsidies provided under Section 1402 are similarly limited as this section expressly provides that cost-sharing reductions are only allowed for "coverage months" for which the aforementioned tax credits are allowed.[13]

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[5] *See* 26 U.S.C. § 36B.

[6] *See* 42 U.S.C. §18041(c)(I).

[7] *New York*, 505 U.S. at 167 ("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.").

[8] *See* 26 U.S.C. § 36B.

[9] 26 U.S.C. § 36B(c)(2).

[10] 26 U.S.C. § 36B(b)(2)(A).

[11] 42 U.S.C. § 18031(d)(1)

[12] 42 U.S.C. § 18024(d).

[13] 42 U.S.C. § 18071(f)(2).

The textual limitation of tax credits to state-established exchanges has implications beyond the affordability of health insurance. Under Section 1513 of the PPACA employers with more than 50 full-time employees are required to offer "minimum essential coverage" to their employees.[14] Failure to offer such insurance can subject employers to a $2,000 fine for every full-time employee beyond the first 30 employees.[15] This penalty is triggered when an employee becomes eligible for tax credits by obtaining a qualifying health insurance plan through a state-run exchange. In addition, because individual exposure to the individual mandate tax penalty is dependent upon the out-of-pocket cost of obtaining qualifying health coverage, the availability of tax credits alters the incidence of the individual mandate's tax penalty.

Portions of the PPACA may not be models of clear legislative drafting, but the provisions authorizing tax credits for the purchase of qualified health insurance plans are abundantly clear. Tax credits are only authorized for qualifying coverage, and such coverage must be obtained through an Exchange "established by the State under section 1311." This language identifies two conditions for the issuance of tax credits – that the Exchange is established "by the State" and that it is established "under section 1311" – each of which requires purchase of the qualifying health coverage in a state Exchange. Indeed, these requirements are part of the definition of what qualifies as eligible health insurance coverage. Coverage obtained anywhere else simply does not qualify.

The IRS Rule

In May 2012, the IRS adopted regulations concerning the availability of health insurance premium tax credits under the PPACA.[16] Under the IRS rule, taxpayers would be eligible for tax credits (and, as a consequence, cost-sharing subsidies) upon purchase of a qualifying health insurance plan without regard to whether the plan was obtained through a state-based exchange under Section 1311 or a federal exchange under Section 1321. Neither the final regulation, nor the proposed rule issued by the IRS in August 2011, identified any specific statutory authority for redefining eligibility for premium assistance tax credits. Indeed, the IRS did not even address the fact that the PPACA expressly defines qualifying health insurance coverage as coverage purchased in an Exchange "established by the State under Section 1311."

In response to concerns that such a rule would extend eligibility for tax credits beyond what was authorized by the PPACA, the IRS offered an extremely cursory response. The justification for the rule offered by the IRS, in its entirety, reads as follows:

> 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

[14] 26 U.S.C. §4980H.

[15] The PPACA provides, in the alternative, that if an employer provides "minimum value" insurance coverage that is not "affordable," the employer is fined $3,000 per employee that receives tax credits or cost-sharing subsidies or $2,000 per employee after the first 30 employees, whichever is less.

[16] Department of the Treasury, Internal Revenue Service, *Health Insurance Premium Tax Credit*, 77 FEDERAL REGISTER 30377 (May 23, 2012), *available at*: http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf.

> 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.[17]

Although commentators had pointed out that the express language of the PPACA limits the availability of the premium tax credits to state-established Exchanges under Section 1311, no additional explanation was offered in the *Federal Register*.

The IRS did not identify any statutory language to justify its interpretation when it finalized the rule. There is a simple explanation for this: There isn't any. This is key because in the absence of such language, the IRS lacks the authority to extend tax credits where Congress has failed to do so. As the Supreme Court has noted repeatedly, it is "axiomatic" that federal agencies only have that authority which has been delegated to them by Congress.[18]

While the IRS claimed that "relevant" legislative history supports its interpretation, it has failed to identify a single statement prior to or contemporaneous with the passage of the PPACA indicating that tax credits were to be available in federal exchanges. Contrary to the IRS's suggestion, the burden is not on opponents of its rule to identify legislative history or statutory language prohibiting the issuance of tax credits in federal exchanges. As the U.S. Court of Appeals for the D.C. Circuit has instructed federal agencies on numerous occasions, Congressional failure to withhold power does indicate such power was delegated, nor does it constitute a statutory ambiguity of the sort that would trigger *Chevron* deference to the Agency's interpretation of the statute.[19] A failure to delegate authority to an agency is just that: A failure to delegate authority.

The language of Section 1401 is crystal clear. Tax credits are available for the purchase of qualifying health coverage in Exchanges "established by the State under section 1311." The failure of Congress to authorize tax credits in federal exchanges means that such tax credits are not authorized.

Post-Hoc Defenses of the IRS Rule

Although the IRS failed to provide any statutory or other legal justification for its decision to extend the availability of tax credits to federal exchanges when it finalized the rule, federal officials and other defenders of the IRS rule have come up with several post-hoc justifications for the IRS decision. None of these arguments can overcome the plain tax of the PPACA.

Several defenders of the IRS rule argue that the language of Section 1321 effectively authorizes the provision of tax credits for the purchase of qualifying health insurance plans. So, for example, in October 2012 a Treasury Department official made the following argument:

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[17] *Id.* at 30378.

[18] See, e.g., Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 208 (1988).

[19] *See, e.g.*, American Bar Association v. Federal Trade Commission, 430 F.3d 457 (D.C. Cir 2005); Railway Labor Executives Association v. National Mediation Board, 29 F.3d 655 (D.C. Cir. 1994).

> section 1311 refers to an exchange being "established by a State." Congress provided in section 1321, however that where a state was not proceeding with an exchange, HHS would establish and operate "*such* Exchange within the State," making a federally-facilitated exchange the equivalent of a state exchange in all functional respects.[20]

Others have made similar arguments.[21]

Under this interpretation, when Section 1321 directs the federal government to create "such Exchange," it is authorizing the federal Section 1321 exchange to operate as a Section 1311 exchange. This is a clever argument, but it's incomplete in that it ignores inconvenient portions of the statutory text. Just because a federal exchange created under Section 1321 is subject to all the same requirements as a state exchange created under Section 1311 does not mean that tax credits available in a state exchange must be available in a federal exchange as well, particularly when the plain text of the statute provides otherwise.

As noted above, Section 1311 expressly requires that an authorized Exchange must be "established by a State" and Section 1304(d) also expressly defines "state" as "each of the 50 States and the District of Columbia." Later amendments to the PPACA also provide that Exchanges created by territories are to be treated as the equivalent of state-run Exchanges, but there is no such language concerning federally run Exchanges.[22] If, as argued, this language of Section 1321 made federal exchanges the equivalent of Section 1311 exchanges, this additional language enacted during the reconciliation process would have been unnecessary.

Even if one were to concede, for the sake of argument, that a Section 1321 Exchange is the equivalent (or "stands in the shoes") of a Section 1311 Exchange, this is still not enough to justify the extension of tax credits in federal exchanges. This is because, as noted above, when Section 1401 defines the coverage for which tax credits may be provided it identifies two relevant conditions: 1) that the insurance is purchased in a Section 1311 exchange, and 2) that the insurance is purchased in an Exchange "established by the State." So one can read Section 1311 to incorporate Section 1321, but a federal Exchange is still not an Exchange "established by the State" as expressly and repeatedly required by Section 1401. To accept this argument in

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[20] *See* Letter from Mark J. Mazur, Assistant Secretary for Tax Policy, U.S. Treasury Department, to the Honorable Darrell Issa, Chairman, Committee on Oversight and Government Reform, U.S. House of Representatives, (Oct. 12, 2012) (emphasis in original).

[21] *See, e.g.*, 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, http://www.healthaffairs.org/blog/2012/07/18/tax-credits-in-federally-facilitated-exchanges-are-consistent-with-the-affordable-care-acts-language-and-history/; Sam Bagenstos, *The Legally Flawed Rearguard Challenge to Obamacare*, BALKINIZATION (Nov. 27, 2012), http://balkin.blogspot.com/2012/11/the-legally-flawed-rearguard-challenge.html.

[22] *See* 26 U.S.C. § 36B(f). This language was added by the Health Care and Education Reconciliation Act, Pub. L. No. 111-152, § 1004, 124 Stat. 1029, 1035 (2010).

defense of the IRS rule is to render this repeated language both redundant and surplusage and violate a fairly fundamental canon of statutory construction.[23]

A second post hoc argument in defense of the IRS rule is that Congress indicated its intention to provide tax credits in federal exchanges by imposing reporting requirements on both state and federal exchanges that include a requirement to report information related to tax credit payment and eligibility. As a Treasury Department official argued in October 2012, the adoption of these requirements as part of the Health Care and Education Reconciliation Act "strongly suggests that all taxpayers who enroll in qualified health plans, either through the federally-facilitated exchange or a state exchange, should qualify for the premium tax credit."[24] This argument also fails.

First, the fact that the authors of the HCERA felt the need to expressly identify both Section 1311 and Section 1321 exchanges shows that the two are not equivalent. If the "such exchange" language noted above were sufficient to make a Section 1321 exchange equivalent to a Section 1311 exchange in all respects, it would have been unnecessary to mention both. Second, the relevant HCERA provisions require the reporting of lots of information that will be of use to federal authorities even apart from the provision of tax credits, including the level of coverage obtained and premiums charged. Insofar as the PPACA is designed to encourage states to create their own exchanges, the collection of information in federal exchanges indicating the level of tax credits or subsidies for which individuals would be eligible under a state exchange would be useful. Third, even were this not the case, enacting a single list of reporting requirements for all exchanges is easier and more efficient than trying to separately delineate what information must be reported by what sort of exchange. Indeed, these reporting requirements apply to types of Exchanges, such as SHOP exchanges, in which the relevant tax credits and cost-sharing subsidies are not available, so the adoption of these reporting requirements *cannot* establish that tax credits and cost-sharing subsidies are available in all exchanges subject to these requirements.

Lacking any statutory language with which to justify the extension of tax credits to federal exchanges, defenders of the IRS rule have argued that the agency's interpretation should be upheld under principles of *Chevron* deference. So, for example, Professor Timothy Jost argued that the IRS rule is valid because an agency's "official construction of an ambiguous statute should be accorded deference by any reviewing court."[25] Simon Lazarus has likewise argued that the IRS rule represents a "permissible interpretation" of the statute and that "courts must defer to an agency's interpretation of a law it is charged with administering, whenever its decision 'is

[23] *See, e.g.*, Duncan v. Walker, 533 U.S. 167, 174 (2001) ("We are . . . 'reluctan[t] to treat statutory terms as surplusage' in any setting" (citation omitted)); Jones v. U.S., 529 U.S. 848, 857 (2000) ("Judges should hesitate ... to treat statutory terms in any setting as surplusage" (citation and internal quotation omitted)). This principle is well established, and has been articulated repeatedly since the Marshall Court. *See, e.g.,* Sturges v. Crowninshield, 17 U.S. (4 Wheat) 122, 202 (1819) (per Marshall, C.J.).

[24] *See* Mazur letter *supra*.

[25] 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/.

based on a permissible construction of the statute.'"[26] Here again, arguments in defense of the IRS rule falter.

Under the *Chevron* doctrine, the first question is whether the relevant statutory text is clear. If so, there is no basis for according deference to an agency interpretation for the agency "must give effect to the unambiguously expressed intent of Congress."[27] It is only when a statute is ambiguous that there is any cause to consider an agency's interpretation of that statute, and even then the agency's interpretation must represent a permissible construction of the relevant statutory text. Further, the question of whether a statute is ambiguous in the first place is one for which the agency receives "no deference" whatsoever.[28] And even a reasonable agency interpretation is only to be accorded deference "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 authority."[29]

The biggest problem with the *Chevron* defense of the IRS rule is that there is nothing ambiguous about the relevant statutory text. Section 1401 is abundantly clear in basing the definition of an eligible coverage month on the purchase of a qualifying health insurance plan in an Exchange "established by the State under Section 1311." The provision's reference to the relevant statutory provision combined with the narrative description of the state-exchange requirement could not be any more clear. Thus there is no reason to even consider applying *Chevron* deference here. 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.[30]

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

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[26] Simon Lazarus, *The Supreme Court Is About to Get Another Change to Gut Obamacare,* THE NEW REPUBLIC, May 13, 2013, http://www.newrepublic.com/article/113194/affordable-care-act-another-supreme-court-challenge.

[27] Chevron USA v. Natural Resources Defense Council, 437 U.S. 837, 842-43 (1984).

[28] *See* Amer. Bar Assn. v. FTC, 430 F. 3d 457, 468 (D.C. Cir. 2005)("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); *see also* Ry. Labor Exec. Ass'n v. Nat'l Mediation Bd., 29 F.3d 655, 671 (D.C.Cir.1994) (en banc).

[29] United States v. Mead Corp., 533 U.S. 218, 226–27 (2001).

[30] 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. *See also* Stuart Taylor, Jr., *Analysis: Health Exchanges And The Litigation Landscape,* KAISER HEALTH NEWS, Nov. 29, 2012, http://www.kaiserhealthnews.org/Stories/2012/November/29/health-law--litigation-and-exchanges.aspx ("As even some health law supporters concede, the claim that Congress denied to the federal exchanges the power to distribute tax credits and subsidies seems correct as a literal reading of the most relevant provisions.").

limit the premium tax credit to State Exchanges."[31] 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.[32] 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."[33] When Congress is silent on a question—such as whether an agency has authority to issue tax credits, 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.

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. Such an argument is tremendously difficult because no matter how much the IRS and its defenders try, there is no way to turn a federal exchange created under Section 1321 into an Exchange "established by the State," let alone "established by the State under section 1311."

A final argument made by defenders of the IRS rule is that there is no plausible reason why Congress would have limited the availability of tax credits to state exchanges. Professor Jost, for example, has argued that there "is no coherent policy reason why Congress would have refused premium tax credits to the citizens of states that ended up with a federal exchange."[34] But of course there is. The PPACA, as enacted, is based upon the Senate health care reform bill. The authors of the Senate bill wanted states to create exchanges. As noted above, the statute even purports to require states to do it. But Congress cannot tell states what to do. Thus it needed to provide them with an incentive to play along, and committing to create a federal exchange as a fallback is not much of a threat, and the promise of startup funding, by itself, is not much of an inducement. So the Senate bill also threatened to withhold benefits – tax credits and subsidies – to citizens of states that did not cooperate by creating their own exchanges. And where did the Senate get this idea? Potentially from Professor Jost, who wrote in 2009 that Congress could try to induce states to create exchanges by, among other things, "offering tax subsidies for insurance

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[31] 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.

[32] *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.").

[33] American Bus Ass'n v. Slater, 231 F.3d 1, 9 (D.C. Cir. 2000) (Sentelle, j., concurring).

[34] 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/.

only in states that complied with federal requirements."[35] While less common than threatening to withhold funds (as was done with Medicaid) this approach is not unprecedented, and multiple pre-enactment Senate health care reform bills contained similar provisions explicitly designed to encourage state cooperation.

Contrary to the claims of some IRS rule supporters, there is nothing "absurd" or unusual with conditioning benefits on state compliance with federal objectives. Congress regularly conditions funding or other federal benefits on state cooperation, and regularly threatens to cut off support to valued constituencies in response to state intransigence. The most obvious example of Congress using this supposedly "absurd" tactic is the Medicaid expansion. Under the PPACA as written, states that refused to participate in the Medicaid expansion would forfeit federal funding for the expansion as well as all federal support for the pre-existing Medicaid program. So not only did Congress threaten to withhold new benefits in unconsenting states, it also threatened to further undermine the PPACA's goals by withdrawing all existing Medicaid funding. In other words, if a state sought to undermine the PPACA by refusing to cooperate with the Medicaid expansion, this would trigger a sanction that would reduce health care coverage for needy populations — a result directly contrary to the stated goal of the PPACA. The Supreme Court ultimately concluded this deal was unconstitutional, but there is no question of what the statute sought to do. The PPACA also limits tax credits and subsidies to those making at least 100 percent of the poverty level, denying such benefits to those most in need. That some might find such a policy "absurd" does not make it any less the law of the land.

Defenders of the IRS rule would like this committee (and the courts) to believe that the language limiting tax credits and subsidies to state-run exchanges is a mistake, perhaps a drafting error. Yet the mistake, if there was one, was not in the drafting of the PPACA, but in the failure to anticipate the widespread resistance the law would face in the states. As the *Washington Post* reported earlier this month, PPACA proponents never even contemplated the possibility that numerous states would refuse to implement their own exchanges. [36] According to the *Post*'s report, when President Obama signed the PPACA into law "there was widespread expectation [states] would want to operate the new insurance exchanges."[37]

Supporters of the IRS rule have identified numerous statements indicating that PPACA supporters expected tax credits to be available in all fifty states. This is because it was universally expected that all states would create exchanges. Administration officials and members of Congress repeatedly said as much. The Congressional Budget Office scored the bill without considering whether tax credits would be limited to state-run exchanges, but it also scored the bill as if the federal government would not have to spend any money paying to implement federal exchanges. Indeed, the PPACA never authorized money for the creation of

[35] Timothy S. Jost, *Health Insurance Exchanges: Legal Issues*, O'Neill Institute, Georgetown University Legal Center, no. 23, April 27, 2009, *available at* http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1022&context=ois_papers. (emphasis added). The earliest known version of this paper was posted online by the Robert Wood Johnson Foundation on January 1, 2009 (http://www.rwjf.org/en/research-publications/find-rwjf-research/2009/01/health-insurance-exchanges.html).

[36] Ezra Klein and Sarah Kliff, *Obama's Last Campaign: Inside the White House Plan to Sell Obamacare*, WASHINGTON POST, July 17, 2013 (noting an "internal White House memo" detailing obstacles to PPACA implementation did not even identify "political opposition or widespread state resistance" as potential hurdles).

[37] *Id.*

federal exchanges, likely because bill supporters did not expect that such funds would be necessary.

Substantial Consequences

The IRS rule at issue is not authorized by law and is thus illegal. By all appearances the IRS also failed to even consider whether there was an adequate legal basis for this rule until *after* the rule was issued. This sort of agency behavior should be enough to concern this subcommittee. The fiscal and other consequences of this rule provide even more reasons for concern.

This rule requires the provision of tax credits in over thirty states that opted not to create their own exchanges. Because these are "refundable" tax credits, this means that the credits do more than provide tax relief to eligible individuals. They result in payments from the U.S. Treasury. Because the Administration has announced that it will not require exchanges to verify eligibility for tax credits, the cost could be significantly greater than many have anticipated. Issuance of the tax credits triggers cost-sharing subsidies that are paid to insurance companies – another draw on the U.S. Treasury. Tax credit eligibility also triggers substantial penalties on employers who fail to provide qualifying health insurance. The availability of tax credits will also expose many individuals to the individual mandate tax penalty who would not otherwise have been so exposed.

In sum, the decision to extend tax credits to federal exchanges will have substantial fiscal and economic consequences. Whether or not extending tax credits and cost-sharing subsidies is a sound policy decision is beyond the scope of this testimony. What should be clear, however, is that this is the sort of policy decision that must be made by Congress, not an individual federal agency. If a majority in Congress believes such tax credits are worthwhile, then Congress may so provide in a statute. Unless and until it has done so, neither the IRS nor any other federal agency has the legal authority to do so.

Conclusion

There are many PPACA supporters who would like tax credits and cost-sharing subsidies to be available in all fifty states, whether or not states create their own exchanges. A bill providing for credits and subsidies nationwide may even have had sufficient support to pass Congress at one time. That is not the law that Congress enacted, however. The law Congress enacted only provides for tax credits and subsidies for the purchase of health insurance in Exchanges established by states. Insofar as the IRS rule purports to provide tax credits and subsidies in federal exchanges, it exceeds the IRS's statutory authority and is contrary to law. The IRS rule is illegal, and should be withdrawn.

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Mister Chairman and members of this committee, I recognize the importance of this issue to you, your constituents, and this nation. I hope that my perspective has been helpful to you today, and I will seek to answer any additional questions you might have. Thank you.