# Dueling Districts on Major Challenge to Federal Health Reform

## Description

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### Are Employers in States Without Exchanges Subject to Penalties?

In two highly technical and comprehensive rulings out July 22, 2014, two federal districts came to opposite conclusions on a key remaining challenge to federal health reform.

The D.C. Circuit Court of Appeals limited the reach of Affordable Care Act ("ACA") employer mandate penalties to states that have their own state Exchange. A few hours later, the 4th Circuit Court of Appeals came to the opposite conclusion.

The controversy turns on a technical statutory issue in the tax code provisions of ACA. The ACA's employer mandate penalties hinge on the availability of tax credits. An employer whose health plan fails certain standards of coverage or affordability standards is subject to a penalty **if** a full-time employee "enroll[s] . . . in a qualified health plan with respect to which an applicable tax credit . . . is allowed or paid with respect to the employee." Under the ACA, an applicable tax credit is available only for the purchase of insurance on an "Exchange established by the State under section 1311 of the [ACA]." However, the IRS adopted a rule interpreting the ACA to allow tax credits for insurance purchased on either a state- or federally-established Exchange.

Therefore, under the pure statutory language of the ACA, tax credits are unavailable for purchases through the federal Exchanges, and employers face no penalties for failing to offer coverage.

Under the IRS rule, however, the tax credit (and employer penalties) are given broader reach. The D.C. Circuit ruled that the IRS rule was invalid because it contradicts the statutory language, and therefore is not authorized by the ACA. The 4th Circuit Court of Appeals held that the rule should be interpreted as part of the entire federal health reform scheme, and that the Congress intended the credit to apply to state and federal exchanges, so the IRS rule should be upheld.

These decisions could have extremely significant ramifications. Unless the Congressional elections swing in favor of Democrats, it is unlikely that the votes could be garnered to conform the ACA text to the IRS regulation. Absent a fix in Congress, the D.C. Circuit decision, if upheld, may cause states with exchanges to consider abandoning their exchanges so that local employers in their states would be shielded from the employer penalty. In addition, if the D.C. Circuit decision is upheld, anyone that enrolled through the federal Exchange may not be eligible for a federal tax subsidy.

It is likely that this issue will be addressed – in some fashion – before the first credits could be taken (in April 2015) or the first penalties would be assessed (in April 2016). Stay tuned!

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