

# **Committee on Oversight and Government Reform**

*Darrell Issa (CA-49), Chairman*

## **Committee on Ways and Means**

*Dave Camp (MI-4), Chairman*



## **Administration Conducted Inadequate Review of Key Issues Prior to Expanding Health Law's Taxes and Subsidies**

**Joint Staff Report  
U.S. House of Representatives**

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## Contents

Executive Summary .....	3
Findings.....	5
I. Introduction .....	8
II. Possible Reasons for Why IRS and Treasury’s Conclusion Is Wrong .....	11
III. IRS Failed to Conduct a Serious Analysis Prior to the Proposed Rule .....	15
<i>IRS Solicited HHS’s Help When the Explicit Statutory Language Proved Problematic</i> .....	17
<i>IRS Did Not Consider the Availability of Subsidies in Federal Exchanges To Be A Significant Issue</i> .....	18
IV. Treasury Failed to Conduct a Serious Analysis of the Issue Between the Proposed and Final Rule.....	20
V. Treasury’s Assistant Secretary for Tax Policy Mark Mazur Never Saw Any Documents Related to Treasury’s Interpretation Produced Prior to May 2012.....	23
VI. Final Rule Provided No Evidence Supporting the Administration’s Interpretation.....	24
VII. IRS Failed to Examine the Entire Statute.....	26
VIII. Treasury Failed to Consider Whether Congress Structured the Premium Subsidies to Elicit State Cooperation.....	28
IX. Treasury Failed to Consider PPACA’s Appropriate Legislative History.....	29
<i>Treasury Relied on Statements Made by House Members About Bills Other Than PPACA</i> ....	31
<i>Treasury Did Not Consider the Senate’s Preference for State Exchanges</i> .....	31
<i>Treasury’s Review of the Legislative History Was Incomplete</i> .....	33
X. Conclusion .....	34

## Executive Summary

In the summer of 2012, the House Committee on Oversight and Government Reform and House Committee on Ways and Means launched separate investigations into the joint Internal Revenue Service (IRS) and Treasury Department rule extending the premium subsidies created by the Patient Protection and Affordable Care Act (PPACA) to individuals purchasing coverage in federal exchanges.<sup>1</sup> According to many legal experts, the IRS rule is precluded by the PPACA statute and incompatible with PPACA's legislative history.<sup>2</sup> These experts found that PPACA expressly and consistently restricts certain provisions (notably premium-assistance tax credits, cost-sharing subsidies, employer-mandate penalties, and in certain cases individual-mandate penalties) to states with "an Exchange established by the State," as opposed to an exchange established by the federal government in states that elected not to establish their own exchange.

For example, in July 2012, the Congressional Research Service's American Law Division (CRS) produced a ten page analysis, including an in-depth review of the statutory text, of the joint IRS and Treasury decision to extend premium subsidies to individuals purchasing coverage in federal exchanges. According to CRS's legal experts, "a strictly textual analysis of the plain meaning of the provision would likely lead to the conclusion that 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."<sup>3</sup> Many experts have indicated that the IRS's rule to allow premium subsidies in federal exchanges, compared to a strict textual reading that would disallow such subsidies, will lead to hundreds of billions of dollars in spending and higher taxes that were not authorized by Congress.<sup>4</sup>

Late in 2012, the House Committee on Ways and Means joined the House Committee on Oversight and Government Reform in its investigation of the IRS rule. Over the past 18 months, the Committees received several briefings and held numerous hearings with key IRS and Treasury personnel involved with the development of the rule. Respective staffs from both Committees have reviewed documents *in camera* at the Treasury Department. The focus of the Committees' investigation was whether IRS and Treasury conducted an adequate review of the statute and legislative history prior to coming to its conclusion that PPACA's premium subsidies would be allowed in federal exchanges.

The evidence gathered by the Committees indicates that neither IRS nor the Treasury Department conducted a serious or thorough analysis of the PPACA statute or the law's legislative history with respect to the government's authority to provide premium subsidies in

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<sup>1</sup> Health Insurance Premium Tax Credit, 77 Fed. Reg. 30377 (May 23, 2012).

<sup>2</sup> 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, 120 (2013); Jennifer Staman and Todd Garvey, CONG. RESEARCH SERV., *Legal Analysis of Availability of Premium Tax Credits in State and Federally Created Exchanges Pursuant to the Affordable Care Act*, (2012).

<sup>3</sup> Staman & Garvey, *supra* note 2.

<sup>4</sup> Adler & Cannon, *supra* note 2, at 120.

exchanges established by the federal government. IRS and Treasury merely asserted that they possessed such authority without providing the Committees with evidence to indicate that they came to their conclusion through reasoned decision-making.

The Committees have learned that IRS and Treasury employees tasked with evaluating the key legal questions surrounding PPACA's premium subsidies did not consider the statutory language expressly precluding subsidies in federal exchanges to be a significant issue. According to two members of the IRS working group who developed the premium subsidy rule, there were other issues related to the premium subsidies that were considered a higher priority and consumed much more of the group's attention when developing the proposed rule.<sup>5</sup> However, the Committees have reviewed documents indicating that, as early as March 2011, IRS and Treasury personnel noticed the lack of statutory language authorizing tax credits in federal exchanges. IRS personnel conveyed their concerns to senior officials with the Department of Health and Human Services (HHS) with the hope that HHS would deem exchanges established by the federal government as state-established exchanges in its rulemaking. Despite expressing concern about a lack of statutory language to authorize premium subsidies in federal exchanges, IRS and the Treasury Department did not conduct a thorough or adequate review of the text and legislative history to determine whether their decision to allow premium subsidies in federal exchanges represented a reasonable interpretation of the statute.

After IRS published the proposed rule, numerous commenters suggested that the rule exceeded the agencies' statutory authority.<sup>6</sup> At least 25 Members of Congress, including Ranking Member Orrin Hatch of the Senate Finance Committee, as well as members of the general public, commented that IRS's proposed rule was incompatible with the language of the statute. Despite these comments, the evidence indicates that IRS and Treasury failed to engage in reasoned decision-making prior to finalizing the rule. For example, Treasury brought in Cameron Arterton, a former staff member to Representative Lloyd Doggett of the House Ways and Means Committee, to review the issue of whether premium subsidies would be available in federal exchanges. The evidence indicates that Ms. Arterton did not consider evidence supporting the statutory language that would have contradicted IRS and Treasury's initial interpretation. The evidence also indicates that IRS and Treasury staff did not consider that the statute may have included language that restricted subsidies to state-established exchanges as an incentive to entice states to implement key provisions of the law.

Despite having nearly a year between the release of the proposed rule and the release of the final rule to review the statute and legislative history for evidence supporting their interpretation, the agencies promulgated a final rule that appears to contradict the plain meaning

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<sup>5</sup> Briefing from IRS & Treasury Officials to Oversight & Gov't Reform and Ways & Means Committee Staff (Apr. 4, 2013) [hereinafter "April 2013 Briefing from IRS & Treasury Officials"]; Briefing from IRS & Treasury Officials to Oversight & Gov't Reform and Ways & Means Committee Staff (June 13, 2013) [hereinafter "June 2013 Briefing from IRS & Treasury Officials"].

<sup>6</sup> See e.g., Health Insurance Premium Tax Credit, Fed. Reg. 76 (Aug. 17, 2011) (Comment of Brian Clark, Sept. 9, 2011); Health Insurance Premium Tax Credit, Fed. Reg. 76 (Aug. 17, 2011) (Comment of Nicole Keading, Oct. 5, 2011); Health Insurance Premium Tax Credit, Fed. Reg. 76 (Aug. 17, 2011) (Comment of David Ford, Oct. 18, 2011); Health Insurance Premium Tax Credit, Fed. Reg. 76 (Aug. 17, 2011) (Comment of Christopher Whitcomb, Aug. 22, 2012).

of the statute. Furthermore, IRS and Treasury have not provided robust evidence in support of their interpretation, nor have they shown evidence that they undertook a thorough review of the law and its relevant legislative history prior to finalizing the rule to ensure that it was consistent with the text of the statute.

## **Findings**

- Early drafts of the proposed premium subsidy regulation contained the statutory language restricting tax credits to Exchanges “established by the State.” This language was removed from those drafts in early March 2011.
- In March 2011, IRS and Treasury officials expressed concern that there was no direct statutory authority to interpret federal exchanges as an “Exchange established by the State.” Specifically, they were concerned there was no statutory provision that would deem a federal exchange to be an “Exchange established by the State.” IRS personnel emailed many senior HHS personnel seeking clarification of the issue in HHS’s rulemaking.
- In March 2011, the IRS Chief Counsel’s office drafted the only written explanation by IRS or Treasury prior to the publication of the proposed rule regarding their decision to extend PPACA’s premium subsidies in federal exchanges. The written explanation contained a single paragraph with a single reason. This single reason apparently served as the Administration’s entire legal basis for providing subsidies in federal exchanges prior to the proposed rule. The only emails Treasury was able to produce for the Committees, even during *in-camera* reviews, from *prior* to the promulgation of the proposed rule, were related to concern about whether the law authorized premium subsidies in federal exchanges. Treasury was not able to produce any emails showing that there was a substantive discussion of whether the law authorized tax credits in federal exchanges.
- After the proposed rule was published, Treasury received comments from numerous individuals, including Members of Congress and the general public, pointing out that the statute does not authorize premium subsidies in federal exchanges. IRS and Treasury have not provided any evidence that these comments were seriously considered.
- Treasury officials told the Committees that “[t]here is no discernible pattern” in the way PPACA uses the term “Exchange.” However, IRS and Treasury employees who worked on the rule and have briefed the Committees said they did not attempt in any way to organize or categorize the use of the term “Exchange” in PPACA.
- Treasury officials did not consider the possibility that Congress intentionally conditioned tax credits and other financial incentives on states establishing their own exchanges as a way to overcome the “commandeering problem.” The commandeering problem refers to the fact that the federal government cannot force a state to implement a federal program.

- IRS and Treasury officials were unaware of a legal journal article written in early 2009 by prominent PPACA supporter and health law expert Timothy Jost suggesting that one way around the commandeering problem was “offering tax subsidies for insurance only in states that complied with federal requirements.”<sup>7</sup>
- Treasury’s Assistant Secretary for Tax Policy Mark Mazur, who wrote a letter to the Chairman of the Oversight and Government Reform Committee, Darrell Issa, defending IRS and Treasury’s interpretation, never saw any analysis of the issue that was produced prior to May 2012, and he did not recall the basis for key statements within the letter about Treasury’s interpretation when interviewed by the Oversight and Government Reform Committee.
- Treasury officials did not consider that PPACA also conditioned other provisions on state cooperation, such as the law’s Medicaid expansion, in deciding whether the absence of authorization for premium subsidies in federal exchanges was intentional.
- Treasury’s review of PPACA’s relevant legislative history on this issue was deeply flawed.
  - Ms. Arterton, a former staffer to Lloyd Doggett, a member of the House Ways and Means Committee, who was put in charge of conducting the review of the law’s legislative history, told the Committees that she never produced a written review of any kind related to her search of the law’s legislative history. IRS and Treasury have not produced any written analysis of the statute’s legislative history with respect to whether Congress intended to offer premium subsidies in federal exchanges.
  - Ms. Arterton’s review of the relevant legislative history considered irrelevant statements made by Members of the House of Representatives prior to the Senate passage of PPACA on December 24, 2009. Such statements do not represent the relevant legislative history because they addressed different bills with different approaches to exchanges and premium subsidies that did not and could not secure sufficient votes to pass both chambers of Congress.
  - Treasury’s review of the legislative history did not consider evidence that the Senate had a clear preference for state exchanges.
  - Treasury’s review of the legislative history did not consider evidence that PPACA’s antecedent bills in the Senate conditioned premium subsidies on state compliance.
  - Treasury’s review of the legislative history did not consider a letter sent in January 2012 by 11 members of Texas’s delegation in the House of Representatives that demonstrates

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<sup>7</sup> Timothy Jost, *Health Insurance Exchanges: Legal Issues*, Geo. Univ. Law Center (Jan. 2009), available at [http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1022&context=ois\\_papers](http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1022&context=ois_papers) [hereinafter “Jost”].

their understanding that PPACA relies heavily on state action in order for its citizens to receive certain benefits under the law.<sup>8</sup>

- Six months prior to the publication of the premium subsidy final rule, Treasury officials, including Ms. Arterton, began looking into whether courts would determine that the statute was ambiguous and defer to the agencies' interpretation, a doctrine known as *Chevron* Deference. Two members of the initial IRS working group could not remember ever working on a previous rule where *Chevron* was discussed, with one member stating that considering *Chevron* prior to the promulgation of a final rule was extremely unusual.

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<sup>8</sup> Letter from Rep. Lloyd Doggett, et al., to President Barack Obama (Jan. 11, 2010), *available at* <http://www.myharlingennews.com/?p=6426> (letter from 11 Members of Texas Cong. Delegation) [hereinafter "Letter from Rep. Lloyd Doggett"].

## I. Introduction

The two primary expenditures within the Patient Protection and Affordable Care Act (PPACA) are a large expansion of Medicaid and subsidies for individuals who purchase coverage in newly created health insurance exchanges. Section 1401 of PPACA, by adding section 36B to the Internal Revenue Code (36B), created a new refundable tax credit for individuals purchasing coverage in state health insurance exchanges who meet certain qualifications.<sup>9</sup> In addition to the new refundable tax credit, Section 1402 of PPACA authorized new payments to insurers to reduce out-of-pocket costs for individuals receiving tax credits and have incomes below 250 percent of the federal poverty level.<sup>10</sup> The non-partisan Congressional Budget Office estimates that federal spending on PPACA's premium subsidies will total nearly \$1.1 trillion over the next decade with another \$700 billion of spending on PPACA's Medicaid expansion.<sup>11</sup>

Although many sections of PPACA are relevant to IRS's decision to authorize PPACA's subsidies in federal exchanges, three sections are the most central.

- Section 1311 of PPACA instructs all states to create health insurance exchanges, which are government-run entities that facilitate the buying and selling of health insurance.<sup>12</sup>
- Section 1321 of PPACA authorizes the Secretary of the U.S. Department of Health and Human Services (HHS) to set up exchanges in states that elect not to create an exchange.<sup>13</sup>
- Section 1401 of PPACA added Section 36B to the Internal Revenue Code. Section 36B authorizes health insurance subsidies for individuals enrolled in coverage through "an Exchange **established by the State under Section 1311.**"<sup>14</sup> [emphasis added]

Nowhere in PPACA are premium tax credits and cost-sharing subsidies directly authorized for individuals who purchase coverage in federal exchanges established by HHS

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<sup>9</sup> I.R.C. § 36B (2012). Applicants who are eligible for tax credits have incomes between 100-400 percent of the federal poverty level, are not eligible for minimum essential coverage through work or government programs such as Medicaid, and are enrolled in a qualified health plan in an Exchange established by a State.

<sup>10</sup> 42 U.S.C. § 18071 (2012). Cost-sharing subsidies are additional payments made to insurers that are used to reduce the enrollee's out-of-pocket costs. Cost-sharing subsidies are available for individuals with incomes between 100 and 250 percent of the federal poverty level, are enrolled in a silver level health plan (qualified health plans with an actuarial value of 70 percent), and receive premium tax credits in state exchanges.

<sup>11</sup> The Congressional Budget Office estimates that federal spending on the Medicaid and insurance subsidies will be \$1.785 trillion dollars from 2014 to 2023. See Congressional Budget Office, *CBO's May 2013 Estimate of the Effects of the Affordable Care Act on Health Insurance Coverage* (2013), [http://www.cbo.gov/sites/default/files/cbofiles/attachments/44190\\_EffectsAffordableCareActHealthInsuranceCoverage\\_2.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/44190_EffectsAffordableCareActHealthInsuranceCoverage_2.pdf).

<sup>12</sup> Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 1311(b)(1), 124 Stat. 119, 173 (2010) [hereinafter "PPACA"].

<sup>13</sup> *Id.* §1321(c).

<sup>14</sup> *Id.* § 1401.



under Section 1321.<sup>15</sup> In July 2012, the Congressional Research Service’s American Law Division issued a report finding that “[t]he plain language of Section 36B suggests that premium tax credits are available only where a taxpayer is enrolled in an ‘Exchange *established by the State* [emphasis added].”<sup>16</sup> According to CRS’s analysis:

[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.<sup>17</sup>

On August 17, 2011, the Internal Revenue Service published a proposed rule (IRS rule) that authorized premium subsidies in both federal and state exchanges.<sup>18</sup> The legal and financial consequences of IRS’s decision to extend the subsidies to individuals purchasing coverage in federal exchanges are enormous since only 16 states and the District of Columbia have elected to establish their own exchanges.<sup>19</sup> Because the population of the 34 states that decided not to create their own exchanges equals roughly two-thirds of the nation’s total population, the IRS’s decision to extend subsidies in federal exchanges potentially created spending that may exceed \$500 billion dollars over 10 years relative to a strictly textual interpretation of the law.<sup>20</sup>

PPACA’s health insurance premium subsidies are linked to the law’s employer mandate.<sup>21</sup> Because of the law’s structure, the employer penalties apply only when at least one of an employer’s full-time workers receives a subsidy. For employers who fail to offer minimum essential coverage to their workers, PPACA’s employer mandate assesses a penalty equal to \$2,000 multiplied by the total number of full-time workers, minus \$60,000.<sup>22</sup> PPACA defines full-time workers as those employees who work more than 30 hours per week.<sup>23</sup> Employers that offer coverage to their workers may still face a penalty equal to \$3,000 for each full-time worker

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<sup>15</sup> I.R.C. § 36B (2012).

<sup>16</sup> Staman & Garvey, *supra* note 2.

<sup>17</sup> *Id.*

<sup>18</sup> Health Insurance Premium Tax Credit, 76 Fed. Reg. 50,931 (Aug. 17, 2011).

<sup>19</sup> Kaiser Family Foundation, *State Decisions For Creating Health Insurance Exchanges, as of May 28, 2013*, STATE HEALTH FACTS (May 28, 2013), available at <http://kff.org/health-reform/state-indicator/health-insurance-exchanges/>. The population of the states with federally-facilitated exchanges and state partnership exchanges equal roughly two-thirds of the U.S. population.

<sup>20</sup> Congressional Budget Office, *supra* note 11. According to CBO’s estimates, the cost of the premium tax credits and cost-sharing subsidies will exceed \$1 trillion over the next decade. Given only a few states have created exchanges, expanding the tax credits and cost sharing subsidies to individuals in states that fail to operate their own exchanges will likely increase spending by hundreds of billions of dollars over the next decade.

<sup>21</sup> I.R.C. § 4980H (2012). The employer mandate only affects businesses with more than 50 full-time equivalent workers. Penalties are assessed on employers who 1) do not offer minimum essential coverage (coverage that would satisfy the individual mandate) to their employees and 2) at least one of their employees receives a subsidy in an exchange.

<sup>22</sup> *Id.* § 4980H(a).

<sup>23</sup> *Id.* § 4980H(c)(4).

who receives a subsidy to purchase insurance in an exchange if the coverage fails to meet other PPACA requirements.<sup>24</sup> When IRS becomes aware that at least one of a company's employees is receiving a tax credit, the IRS will assess the company's total penalty. According to the Congressional Budget Office, this penalty will cost Americans \$140 billion over the next decade.<sup>25</sup> Since 34 states have refused to create state exchanges, the IRS rule, which offers these subsidies in federal exchanges potentially imposes tens of billions of dollars in penalties on employers in states with federal exchanges relative to a strictly textual interpretation of the law.<sup>26</sup> Moreover, to avoid the employer mandate tax penalties, many employers will opt to reduce their number of full-time workers by shifting workers to part-time status. This is because employers do not pay penalties for part-time employees who receive subsidies in an exchange.

Due to concerns that IRS and Treasury's decision to extend premium subsidies in federal exchanges is inconsistent with the text of PPACA and the potential of hundreds of billions of dollars in unauthorized taxes and spending, the Committee on Oversight and Government Reform and the Committee on Ways and Means have conducted oversight of IRS's decision to extend PPACA's taxes and premium subsidies to individuals residing in states that elected not to establish an exchange.

After the publication of the premium tax credit final rule on May 23, 2012, several Members of Congress, including Darrell Issa, Chairman of the Committee on Oversight and Government Reform, wrote IRS noting that PPACA does not authorize premium subsidies in federal exchanges. Chairman Issa wrote:

While PPACA requires the Secretary of Health and Human Services to "establish and operate" an Exchange within any state that fails to create one on its own, PPACA does not contain any language that contradicts or overrides the explicit language limiting premium-assistance tax credits to Exchanges established by states only. Since most states, to date, have opted not to create Exchanges, IRS's extension of the tax credits beyond what the statute authorizes likely increases PPACA's cost in excess of \$500 billion over the next decade. Moreover, since employers are only subject to PPACA's employer mandate tax penalties if their workers receive PPACA's premium-assistance tax credits, IRS's rule subjects employers in every state to the employer mandate tax penalty.<sup>27</sup>

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<sup>24</sup> *Id.* § 4980H(b). In this case, if an employer offers minimum essential coverage to their workers, but the coverage does not meet a statutory standard for affordability and minimum value, the employer will be assessed a \$3,000 penalty for each worker that receives a subsidy in the exchange.

<sup>25</sup> Congressional Budget Office, *supra* note 11.

<sup>26</sup> *Id.* Also, there is a connection with exchange subsidies and penalties under the individual mandate. According to the statute, individuals will be exempt from penalties if their required contribution for insurance coverage exceeds eight percent of income. Because subsidies would effectively reduce the required contribution for individuals who qualify for them, the IRS rule will subject many individuals, who reside in states that refused to create exchanges, to penalties compared to an interpretation consistent with the plain statutory language. *See* I.R.C. § 5000A(e)(1)(A).

<sup>27</sup> Letter from Darrell Issa, Trey Gowdy, and Scott DesJarlais, to Douglas H. Shulman, Commissioner, Internal Revenue Service (Aug. 20, 2012).

The Committee on Oversight and Government Reform and the Committee on Ways and Means have requested information and documents from Treasury and IRS about the rule, including “all legal analysis, internal or external, conducted by IRS which authorizes IRS to grant premium-assistance tax credits in federal Exchanges.”<sup>28</sup> The Committees conducted three interviews, on November 2, 2012,<sup>29</sup> on April 4, 2013,<sup>30</sup> and on June 13, 2013,<sup>31</sup> with IRS and Treasury employees involved with the promulgation of the 36B rule. The Committee on Oversight and Government Reform conducted a transcribed interview with Mark Mazur, Assistant Secretary for Tax Policy, on January 16, 2014.<sup>32</sup> The Committees have also reviewed, *in-camera*, four internal Treasury Documents related to the rule. On September 24, 2013, staff from the Committee on Oversight and Government Reform conducted another in-camera review of additional materials related to the 36B rulemaking.<sup>33</sup>

This joint staff report shows that IRS and Treasury arrived at the decision to extend premium subsidies to federal exchanges without a thorough or proper analysis. There is simply no evidence that IRS conducted an adequate analysis of this issue prior to the issuance of the proposed rule. On three separate occasions, IRS and Treasury employees were unable to provide the Committees with detailed information about the factors they considered before determining that premium subsidies should be allowed in federal exchanges. When the potential illegality of the rule was raised by members of the general public and Members of Congress after the publication of the proposed rule, the evidence suggests that IRS and Treasury once again failed to conduct a careful review and simply reiterated their original assertions. While prior to the proposed rule, IRS and Treasury’s failure to conduct an adequate review of whether the text of law and PPACA’s legislative history supported its interpretation was largely due to other pressing priorities with the 36B regulation. IRS and Treasury’s failure to engage in reasoned decision-making in the period between the proposed rule and the final rule is inexcusable, however, and significantly calls into question the merits of IRS and Treasury’s interpretation.

## **II. Possible Reasons for Why IRS and Treasury’s Conclusion Is Wrong**

This section lists IRS and Treasury’s four rationales for their interpretation as well as possible rebuttal arguments that have been made for each rationale. Given the strong arguments in opposition to IRS and Treasury’s interpretation and the magnitude of the taxes and spending resulting from such interpretation, the Committees’ investigation focused on whether the government did a thorough and reasoned review of the law’s text and legislative history before reaching its conclusion. After this section, the remainder of the report focuses on the Committees’ findings about the type of analysis conducted by IRS and Treasury.

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<sup>28</sup> *Id.*

<sup>29</sup> Briefing from IRS & Treasury Officials to Oversight & Gov’t Reform and Ways & Means Committee Staff (Nov. 2, 2012) [hereinafter “November 2012 Briefing from IRS & Treasury Officials”].

<sup>30</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>31</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>32</sup> Transcribed Interview with Mark Mazur, Assistant Sec’y for Tax Policy, U.S. Treasury Dep’t, in Wash., D.C. (Jan. 16, 2014) [hereinafter “Interview with Mark Mazur”].

<sup>33</sup> Review of Treasury Documents related to 36B Rulemaking (Sept. 24, 2013).

In a letter dated October 12, 2012, Mark Mazur, Assistant Secretary for Tax Policy, wrote to Chairman Issa with an explanation of the Administration's justification for the rule.<sup>34</sup> Mr. Mazur provided four arguments in support of the Administration's interpretation:

1. In the Treasury response to Chairman Issa, Mr. Mazur wrote:

ACA 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.*<sup>35</sup> [emphasis added]

#### *Potential Flaws with this Argument*

Treasury's analysis seems to ignore one of the primary rules of statutory construction, which is when interpreting a statute, the first place to look is the plain meaning of the text.<sup>36</sup> As the CRS analysis noted, "the plain meaning of the provision would likely lead to the conclusion that 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."<sup>37</sup> First, the text of 36B provides premium subsidies only to taxpayers who enroll in an "exchange established by the State and under Section 1311."<sup>38</sup> The text of Section 36B contains two separate clauses that limit the availability of premium subsidies to state-established exchanges. First, the exchange must be established by a state. PPACA defines a state as one of "the 50 States and the District of Columbia."<sup>39</sup> Second, the exchange must be established under Section 1311 of PPACA. Even if, federal exchanges (established by Section 1321 of PPACA) are functionally equivalent to state exchanges (established by Section 1311 of PPACA), the federal government cannot be considered a state, as defined by PPACA. Ignoring the phrase "established by the State" violates the rules of statutory construction by depriving that provision of its plain meaning.<sup>40</sup> In fact, documents reviewed by the Committees show that at the end of March 2011, Treasury and IRS officials expressed

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<sup>34</sup> Letter from Mark J. Mazur, Assistant Sec'y for Tax Policy, U.S. Treasury Dep't, to Rep. Darrell Issa, Chairman, Committee on Oversight and Government Reform, U.S. House of Representatives (Oct. 12, 2012) (on file with the Committee on Oversight and Government Reform) [hereinafter "Letter from Mark J. Mazur"].

<sup>35</sup> *Id.*

<sup>36</sup> See Cornell University Law School, Legal Information Institute, *Statutory Construction*, [http://www.law.cornell.edu/wex/statutory\\_construction](http://www.law.cornell.edu/wex/statutory_construction) (last visited Jan. 27, 2014).

<sup>37</sup> Staman & Garvey, *supra* note 2.

<sup>38</sup> I.R.C. § 36B (2012).

<sup>39</sup> PPACA, Pub. L. No. 111-148, § 1304(d), 124 Stat. 119, 172 (2010).

<sup>40</sup> Treasury used this very principle to defend their requirement that employers offer health coverage to both their employees and their employee's dependents. See Shared Responsibility for Employers Regarding Health Coverage, 78 Fed. Reg. 231 (Jan. 2, 2013) ("The fundamental rules of statutory construction provide that effect must be given, to the extent possible, to every word, clause and sentence. See Norman Singer and J.D. Shambie Singer, 2A Sutherland Statutory Construction 46:6 (7th ed. 2007). Applying these principles to the words "employees (and their dependents)," the language cannot be construed to mean only employees. To accept the commenters' argument that the statute requires an offer of coverage only to full-time employees would require ignoring the words "and their dependents" in their entirety.").

concern that there was no direct statutory authority to interpret federal exchanges as an exchange established by a state.<sup>41</sup>

2. Treasury argued that the requirement contained in the Health Care and Education Reconciliation Act (HCERA) for federal exchanges to report information on premium subsidies would only make sense if these subsidies were available in federal exchanges, as well as state exchanges. Mr. Mazur wrote:

[T]he information reporting requirements of section 36B(f)(3) apply to exchanges under both ACA sections 1311 and 1321. This requirement relates to administration of the premium tax credit. The placement of this provision in section 36B and the information required to be reported - including information related to eligibility for the credit and receipt of advance payments - 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.<sup>42</sup>

#### *Potential Flaws with this Argument*

The inclusion of the reporting requirement in the reconciliation bill shows that Congress did not view federal and state exchanges as equivalent and actually undermines the Administration's first argument. At a hearing before the Committee on Oversight and Government Reform on July 31, 2013, Jonathan H. Adler, a law professor at Case Western Reserve University who has extensively studied the IRS rule, testified:

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.<sup>43</sup>

3. In his letter to Chairman Issa, Mr. Mazur wrote that "[w]e interpreted the statutory language in context and consistent with the purpose and structure of the statute as a whole...."<sup>44</sup> Treasury's argument is that limiting tax credits only to states that established exchanges would run contrary to the purpose of the law, which according to senior Treasury officials

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<sup>41</sup> Review of Treasury Documents related to 36B Rulemaking (Sept. 24, 2013).

<sup>42</sup> Letter from Mark J. Mazur, *supra* note 34.

<sup>43</sup> *Oversight of IRS's Legal Basis for Expanding ObamaCare's Taxes and Subsidies, Hearing Before Subcomm. on Energy Policy, Health Care, and Entitlements of the H. Comm. on Oversight and Government Reform, 113th Cong. (July 31, 2013) (Testimony of Jonathan H. Adler, Johan Verheji Memorial Professor of Law, Case Western Reserve Univ. School of Law), available at <http://oversight.house.gov/wp-content/uploads/2013/07/Adler-Testimony-Final.pdf> [hereinafter "Testimony of Jonathan H. Adler"].*

<sup>44</sup> Letter from Mark J. Mazur, *supra* note 34.

was to provide affordable health insurance to all Americans.<sup>45</sup> For example, a February 2012 memo, written prior to the publication of the final rule on premium tax credits, stated that “[i]nterpreting the language [of IRC §36B] as a restriction is inconsistent with the broad scheme of the ACA to increase health insurance availability.”<sup>46</sup> Emily McMahon, then Acting Assistant Secretary for Tax Policy at the Department of Treasury, testified at a Committee hearing that “the purpose of the Affordable Care Act, as we understand it, was to achieve universal healthcare coverage, affordable healthcare coverage for citizens in every state.”<sup>47</sup>

### *Potential Flaws with this Argument*

Contrary to Treasury’s argument, Congress often conditions benefits on state compliance with federal objectives. For example, in 1984, Congress conditioned a portion of federal highway funds on states implementing a minimum drinking age of 21 years old.<sup>48</sup> Moreover, within PPACA, Congress explicitly tied federal funding to state compliance with the law’s Medicaid expansion.<sup>49</sup> Before the Committee on Oversight and Government Reform, Professor Adler testified:

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.<sup>50</sup>

Even after the U.S. Supreme Court declared unconstitutional PPACA’s provision withdrawing all Medicaid funds from states that did not expand their Medicaid programs,

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<sup>45</sup> *Oversight of IRS’s Legal Basis for Expanding ObamaCare’s Taxes and Subsidies, Hearing Before Subcomm. on Energy Policy, Health Care, and Entitlements of the H. Comm. on Oversight and Government Reform, 113th Cong. (July 31, 2013) (Statement of Emily McMahon, Deputy Assistant Sec’y for Tax Policy, U.S. Dep’t of Treasury) [hereinafter “Statement of Emily McMahon”].*

<sup>46</sup> Memorandum, Pre-final legal analysis (Feb. 2012).

<sup>47</sup> Statement of Emily McMahon, *supra* note 45.

<sup>48</sup> See the National Minimum Drinking Age Act, Pub. L. No. 98-363, 98 Stat. 435 (1984) (codified as amended at 23 U.S.C. § 158 (2012)). This policy was challenged by the State of South Dakota, but was upheld by the U.S. Supreme Court. See *South Dakota v. Dole*, 483 U.S. 203 (1987).

<sup>49</sup> 26 states challenged the provision that conditioned all federal Medicaid funds on states expanding Medicaid. The states argued the provision as too coercive. The Supreme Court agreed and ruled the provision unconstitutional. This effectively made the Medicaid expansion optional. See *Nat’l Fed’n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

<sup>50</sup> Testimony of Jonathan H. Adler, *supra* note 43.

PPACA’s Medicaid expansion still functions exactly the same as the provision making subsidies available only in state-created exchanges. Just as additional federal funding of state Medicaid programs was used as an incentive for states to expand their Medicaid program, Congress provided premium subsidies to entice states to establish their own exchanges.

4. In his response to the Chairman’s letter, Mr. Mazur wrote that “[o]ur interpretation is consistent with the explanation of the ACA released by the nonpartisan Congressional Joint Committee on Taxation and with the assumptions made by the Congressional Budget Office in estimating the effects of the ACA.”<sup>51</sup>

### *Potential Flaws with this Argument*

The Congressional Budget Office budget impact score and the Joint Committee on Taxation report are both consistent with the plain text reading that premium subsidies would only be available in state established exchanges.<sup>52</sup> Neither report stated that premium subsidies would be available in federal exchanges. Rather, these reports reflected the widespread assumption that all states would create exchanges.<sup>53</sup> In fact, CBO confirmed that they did not conduct a legal analysis of whether premium subsidies would be available on federal exchanges.<sup>54</sup> Furthermore, during the time period the law was being debated, CBO was inundated with requests to score various changes to the proposed health care bill. The Director of CBO, Douglas Elmendorf, told the Committees that CBO also only had a single full-time lawyer on staff during this time period.<sup>55</sup>

### **III. IRS Failed to Conduct a Serious Analysis Prior to the Proposed Rule**

After PPACA was signed into law, IRS assembled a working group, dubbed the 36B Working Group, to develop regulations pertaining to PPACA’s premium subsidies. The 36B Working Group, which consisted mostly of career IRS and Treasury employees, was formed in

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<sup>51</sup> Letter from Mark J. Mazur, *supra* note 34.

<sup>52</sup> Letter from Douglas W. Elmendorf, Director, Cong. Budget Office, to Sen. Evan Bayh, U.S. Senate, An Analysis of Health Insurance Premiums Under the Patient Protection and Affordable Care Act (Nov. 30, 2009), <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/107xx/doc10781/11-30-premiums.pdf>; Joint Comm. on Taxation, Technical Explanation of The Revenue Provisions of The “Reconciliation Act Of 2010,” As Amended, in Combination with the “Patient Protection and Affordable Care Act” (Mar. 21, 2010).

<sup>53</sup> See, e.g., The White House, Office of the Press Secretary, Remarks by the President on Health Insurance Reform in Portland, Maine (Apr. 1, 2010), available at <http://www.whitehouse.gov/the-press-office/remarks-president-health-insurance-reform-portland-maine> (“And then, by 2014, each state will set up what we’re calling a health insurance exchange....”) (emphasis added).

<sup>54</sup> Letter from Douglas W. Elmendorf, Director, Cong. Budget Office, to Rep. Darrell Issa, Chairman, Committee on Oversight and Government Reform, U.S. House of Representatives (Dec. 6, 2012), <http://www.cbo.gov/sites/default/files/cbofiles/attachments/43752-letterToChairmanIssa.pdf>.

<sup>55</sup> Meeting with Committee staff and Douglas Elmendorf (Dec. 12, 2012).

the late summer of 2010 and met for about two hours per week while developing the proposed rule for 36B.<sup>56</sup>

In the June 13, 2013, briefing, two senior IRS attorneys who worked on the 36B rule told the Committees that they did not consider the availability of tax credits in federal exchanges as a central issue during the rulemaking process and they spent relatively little time on it.<sup>57</sup> Chip Dunham, a lawyer in the income tax and accounting division at the Office of the Chief Counsel, mentioned that the issue was discussed but that it was not considered a key issue.<sup>58</sup> Kim Koch, a lawyer in the health care division at the Office of the Chief Counsel, told the Committees that IRS employees working on the rule were extremely busy discussing and drafting the regulation during that time and many other issues related to the tax credits were a higher priority.<sup>59</sup> Additionally, according to all seven IRS and Treasury employees interviewed by the Committees, there was an early consensus that these tax credits would be available in all exchanges.<sup>60</sup>

According to IRS and Treasury employees interviewed by the Committees, the first discussion of whether the Administration had the statutory authority to provide subsidies in federal exchanges occurred in March 2011.<sup>61</sup> Emily McMahon, then Acting Assistant Secretary for Tax Policy at the Department of Treasury, saw an article in *Bloomberg BNA* which discussed the legal challenges to PPACA.<sup>62</sup> The article referenced remarks by Thomas Christina, an employee benefits attorney, who had discussed the restriction of PPACA's premium tax credits to citizens of states that elected to create exchanges at an American Enterprise Institute conference held on December 6, 2010.<sup>63</sup> According to the article:

[T]he individual income tax credit under Section 1401 [IRC § 36B] available for citizens of states that have established their own exchanges is not available to citizens of states with HHS exchanges, he [Mr. Christina] noted. He termed this an “extraordinary” dangling of money directly before voters.<sup>64</sup>

Ms. McMahon then forwarded the *Bloomberg BNA* article to the working group for their input. At the June 13, 2013, briefing, both Mr. Dunham and Ms. Koch told the Committees that

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<sup>56</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5. Member of the IRS Working Group interviewed by the Committee Staff were: Chip Dunham, Income Tax and Accounting division for IRS chief counsel, Dunham was involved in the drafting of the 36B regulation; Kim Koch, Health Care Counsel at the Office of Chief Counsel at IRS; Cameron Arterton, Office of Tax Legislative Counsel in the Department of Treasury, Arterton joined the Working Group in October 2011 and was the author of the legal review memo written prior to the final rule's publication.

<sup>57</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>61</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>62</sup> *Id.*

<sup>63</sup> Thomas D. Edmonson, *Opponents of New Federal Health Care Law Wage Constitutional War in Courts*, BLOOMBERG BNA (Jan. 4, 2011).

<sup>64</sup> *Id.*



they discussed the article.<sup>65</sup> However, they were unable to provide any details on these discussions other than the working group’s conclusion that PPACA’s tax credits should be available in both state and federal exchanges. According to documents reviewed by Committee staff *in camera*, 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.”<sup>66</sup> 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.<sup>67</sup>

At the June 13, 2013, briefing, Mr. Dunham and Ms. Koch told the Committees that they discussed whether to elevate the issue to a larger departmental group, which included senior IRS and Treasury officials, for additional comments and discussion as part of a meeting covering many topics.<sup>68</sup> The working group ultimately decided to elevate the issue to the larger departmental group and in preparation for the larger group meeting on the 36B regulation on March 25, 2011, IRS’s Chief Counsel’s Office drafted a memo to explain the issue to the attendees. The memo consisted of the following analysis:

§1321 (c)(1) of the PPACA provides that if a state fails to establish an exchange, the Secretary of HHS will, directly or through a nonprofit, establish and operate “such” exchange within the state and implement the other exchange requirement. This language indicates that when HHS established an exchange, it do [sic] so as the surrogate of the state, and that Congress viewed an exchange established by HHS as the equivalent of an exchange a state establishes directly. Thus, the phrase “established by a state” may be interpreted to refer to an exchange established to operate in a state. Accordingly, all exchanges established within a state under PPACA, including those HHS must establish on the state’s behalf, are exchanges established by the state under §1311 of the PPACA.<sup>69</sup>

According to IRS and Treasury personnel, this one-paragraph analysis is the only written analysis produced by Treasury and IRS regarding the availability of premium subsidies in federal exchanges before the proposed rule was issued.<sup>70</sup> IRS and Treasury employees interviewed by the Committees could not remember any details about the larger group meeting where the issue was discussed,<sup>71</sup> and IRS and Treasury have refused to provide the Committees with notes from the meeting.

#### *IRS Solicited HHS’s Help When the Explicit Statutory Language Proved Problematic*

On September 24, 2013, Committee on Oversight and Government Reform staff conducted an in-camera review of deliberative materials related to the IRS rule.<sup>72</sup> The review

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<sup>65</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>66</sup> Based on draft versions of 36B proposed rule reviewed by Committee staff (Sept. 24, 2013).

<sup>67</sup> *Id.*

<sup>68</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>69</sup> Memorandum from IRS Office of Chief Counsel, Pre-final Legal Analysis (Aug. 2011).

<sup>70</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>71</sup> *Id.*

<sup>72</sup> Review of Treasury Documents related to 36B Rulemaking (Sept. 24, 2013).

consisted primarily of draft versions of both the proposed and final 36B rule.<sup>73</sup> Committee staff also reviewed an email sent after the March 25, 2011, large group meeting, where the issue of subsidy availability in federal exchanges was discussed.<sup>74</sup> This email highlighted three specific points. First, Treasury and IRS considered that the language restricting tax credits to state-established exchanges may have been a “drafting oversight.”<sup>75</sup> Second, the email between Treasury department employees expressed concern that there was no direct statutory authority to interpret an HHS exchange as an “Exchange established by the State.”<sup>76</sup> Third, the email suggested that IRS request HHS clarify the issue in their rulemaking by deeming HHS exchanges to be exchanges established by States.<sup>77</sup>

On March 27, 2011, IRS employees then sent an email to several HHS officials, including Cindy Mann (Deputy Administrator at the Centers for Medicare and Medicaid Services), Penny Thompson (Deputy Director of the Center for Medicaid and CHIP Services, within the Centers for Medicare & Medicaid Services), and Chiquita Brooks LaSure (Deputy Director for Policy and Regulations at the Center for Consumer Information & Insurance Oversight), asking that HHS remedy the problem by deeming HHS exchanges to be exchanges established by states in HHS’s exchange regulation.<sup>78</sup> HHS issued their proposed rule on Health Insurance Exchanges on July 15, 2011. According to the proposed rule:

The definition for an “Exchange” in § 155.20 is drawn from the statutory text in section 1311(d)(1) and 1311(d)(2)(A). We interpret section 1321(c) of the Affordable Care Act to mean that this definition includes an Exchange established or operated by the Federal government if a State does not establish an Exchange.<sup>79</sup>

After the HHS proposed exchange rule was released, IRS and Treasury incorporated the HHS definition of exchange into their premium tax credit rule.<sup>80</sup>

### *IRS Did Not Consider the Availability of Subsidies in Federal Exchanges To Be A Significant Issue*

When the 36B proposed rule was finalized, the text of the proposed rule was sent to Emily McMahon for review. As part of the regulatory clearance process, a policy memo written by David Gamage, a counsel in Treasury’s Office of Tax Policy, accompanied the proposed rule. The memo contained a section titled “Significant Issues and Considerations,” with four areas

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<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> Establishment of Exchanges and Qualified Health Plans, 76 Fed. Reg. 41,868 (July 15, 2011).

<sup>80</sup> See Health Insurance Premium Tax Credit, 76 Fed. Reg. 50932 (Aug. 17, 2011) (“Exchange has the same meaning as in 45 CFR 155.20.”). HHS’s definition of exchanges does not specifically address whether federal exchanges would be allowed to provide premium tax credits.

highlighted.<sup>81</sup> The four areas of the proposed rule that IRS was most concerned about were: changes in circumstances and reconciliation of the advanced premium tax credits,<sup>82</sup> the affordability standard for employer sponsored coverage,<sup>83</sup> the minimum value standard for employer sponsored insurance,<sup>84</sup> and individuals with household income below 100% of the federal poverty level being ineligible for the premium subsidies.<sup>85</sup> Notably absent from this memo was any discussion of whether federal exchanges were authorized by the statute to provide premium subsidies.

On August 17, 2011, IRS published the premium tax credit proposed rule. In the proposed rule, IRS made these tax credits available in both state and federal exchanges. According to the proposed rule:

[A] taxpayer is eligible for the credit for a taxable year if the taxpayer is an applicable taxpayer and the taxpayer or a member of the taxpayer's family (1) is enrolled in one or more qualified health plans through an Exchange established under section 1311 *or* 1321 of the Affordable Care Act (42 U.S.C. 13031 or 42 U.S.C. 18041) and (2) is not eligible for minimum essential coverage other than coverage in the individual market.<sup>86</sup> [emphasis added]

As already discussed, the Committees learned that by March 25, 2011, members of the 36B Working Group were aware that IRS potentially lacked the statutory authority to offer PPACA's premium subsidies in federal exchanges. Despite this knowledge, IRS failed to conduct a thorough or serious analysis of the issue prior to the release of the proposed rule. The only written analysis explaining IRS's decision to extend PPACA's subsidies to individuals who purchase coverage in federal exchanges was the single memo produced by IRS's Office of Chief Counsel with a single paragraph with a single reason to support their interpretation.

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<sup>81</sup> Memorandum from David Gamage, Counsel, U.S. Treasury Dep't, Office of Tax Policy, to Emily McMahon, Deputy Assistant Sec'y, U.S. Treasury Dep't, Proposed rule clearance package (Aug. 5, 2011).

<sup>82</sup> Tax credits must be reconciled with actual income at the end of the year. Individuals that an amount of advanced higher than what the statute entitles them will be forced to repay the excess payments. IRS's concern was that individuals who experience an unforeseen change in circumstances may be forced to repay significant amounts despite not doing anything wrong. See I.R.C. § 36B(f) (2012).

<sup>83</sup> Employees and their families will not be eligible for tax credits if the employee contribution for self-only coverage is considered "affordable," or less than 9.5 percent of the household income. As a result, some families will find themselves ineligible for subsidies because the cost for self-only coverage is considered "affordable," even though the cost of family coverage is not. See I.R.C. § 36B(c)(2)(C).

<sup>84</sup> If an employer offers coverage that is considered affordable and meets the statutory definition for providing minimum value (plan premiums cover at least 60 percent of the allowed costs), then neither the individual nor members of their family will be eligible for premium subsidies. See I.R.C. § 36B(c)(2)(C).

<sup>85</sup> I.R.C. § 36B(c)(1)(A).

<sup>86</sup> Health Insurance Premium Tax Credit, 76 Fed. Reg. 50,932 (Aug. 17, 2011).

#### **IV. Treasury Failed to Conduct a Serious Analysis of the Issue Between the Proposed and Final Rule**

The rule-making process, as set in the Administrative Procedure Act, generally requires a notice and comment period.<sup>87</sup> The main purpose of a comment period is for commenters to highlight issues for additional consideration by the agency. After the proposed rule was published, many commenters, including Members of Congress pointed out that individuals purchasing coverage in federal exchanges would not be eligible for PPACA's subsidies. However, the Committees have learned that neither IRS, nor Treasury, took the issue seriously and that a thorough and complete review of this important issue was not conducted prior to the Administration's final rule.

After the proposed rule was published, many individuals questioned whether IRS had the statutory authority to offer premium subsidies in federal exchanges. IRS received several comments that pointed out that IRS lacked the statutory authority to provide tax credits in federal exchanges.<sup>88</sup> IRS's lack of authority to issue the rule was also reported in *Investor's Business Daily* on September 7, 2011.<sup>89</sup> James Blumstein, a respected health law professor, suggested that employers might challenge the employer mandate fines because premium subsidies in federal exchanges was unauthorized and employers are only subject to the fines if at least one of their workers receives an exchange subsidy.<sup>90</sup> On November 18, 2011, Michael Cannon and Jonathan Adler wrote in a *Wall Street Journal* op-ed that that IRS lacked authority to provide subsidies in federal exchanges, noting that "[t]he text of the law is perfectly clear. And without congressional authorization, IRS lacks the power to dispense tax credits or spend money."<sup>91</sup>

On December 1, 2011, Senator Orrin Hatch, Ranking Member of the Senate Finance Committee, wrote to IRS Commissioner Douglas Shulman suggesting that the Administration lacked statutory authority to provide subsidies in federal exchanges. Senator Hatch wrote:

It appears that these regulations, implementing Section 36B of the Internal Revenue Code, are inconsistent with the relevant statutory language. I am concerned that if finalized, these rules would exceed your regulatory authority, violating the Constitution's separation of powers.<sup>92</sup>

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<sup>87</sup> 5 U.S.C. § 551 (2012).

<sup>88</sup> See e.g., Health Insurance Premium Tax Credit, Fed. Reg. 76 (Aug. 17, 2011) (Comment of Brian Clark, Sept. 9, 2011); Health Insurance Premium Tax Credit, Fed. Reg. 76 (Aug. 17, 2011) (Comment of Nicole Keading, Oct. 5, 2011); Health Insurance Premium Tax Credit, Fed. Reg. 76 (Aug. 17, 2011) (Comment of David Ford, Oct. 18, 2011); Health Insurance Premium Tax Credit, Fed. Reg. 76 (Aug. 17, 2011) (Comment of Christopher Whitcomb, Aug. 22, 2012).

<sup>89</sup> David Hogberg, *Oops! No ObamaCare Tax Credit Via Federal Exchanges?*, INVESTOR'S BUSINESS DAILY, Sept. 16, 2011, <http://news.investors.com/090711-584085-oops-no-obamacare-tax-credit-via-federal-exchanges-.htm>.

<sup>90</sup> David Hogberg, *Companies Could Challenge ObamaCare Employer Fines*, INVESTOR'S BUSINESS DAILY, Sept. 16, 2011, <http://news.investors.com/091611-585053-companies-could-challenge-obamacare-employer-fines.htm>.

<sup>91</sup> Jonathan H. Adler & Michael F. Cannon, *Another ObamaCare Glitch*, WALL ST. J., Nov. 16, 2011, <http://online.wsj.com/article/SB10001424052970203687504577006322431330662.html>.

<sup>92</sup> Letter from Sen. Orrin G. Hatch, U.S. Senate, to Timothy Geithner, Secretary, U.S. Treasury Dep't (Dec. 1, 2011).

Senator Hatch also wrote that the proper avenue for changes to the statute would be through the legislative process, which he noted is “exclusively granted to Congress.”<sup>93</sup> Congressman David P. Roe, along with 23 other members of the House of Representatives, also wrote to IRS Commissioner Shulman.<sup>94</sup> Their letter requested that IRS “amend the proposed rule’s language to be consistent with PPACA’s statutory text.”<sup>95</sup>

During the series of briefings with Committee staff, IRS and Treasury staff asserted that they had considered the numerous comments related to their interpretation of the statute.<sup>96</sup> However, no one at IRS or Treasury interviewed by the Committees was able to remember details about their discussions of these comments.<sup>97</sup> Cameron Arterton, a Deputy Tax Legislative Counsel for Treasury hired in late 2011, was brought in to conduct a review of the legislative text and history surrounding the issue of whether tax credits should be available in federal exchanges. Ms. Arterton, who also wrote the policy memo that accompanied the 36B final rule draft when it was submitted for clearance, did not remember ever discussing the issue of whether the statute authorized premium subsidies in federal exchanges with other members of the working group developing the 36B rule.<sup>98</sup>

According to an email exchange reviewed by the Committee on Oversight and Government Reform, Treasury officials began considering the applicability of *Chevron* to this issue nearly six months before the promulgation of the final rule.<sup>99</sup> On December 1, 2011, Jessica Hauser, Deputy Tax Legislative Counsel at the Department of Treasury, sent an email to Ms. Arterton, with the subject line “can you send me and Jeff [Van Hove, former Tax Legislative Counsel]... The two good chevron cases?”<sup>100</sup> Later that day, Ms. Arterton emailed her response:

Here are the two Chevron cases you asked for (plus Chevron for good measure)... I should also be clear that I don’t think these cases are unique in the proposition that tension/conflict between two statutory provisions can create sufficient ambiguity, these are just the two clearest I have found so far.<sup>101</sup>

*Chevron* refers to the Supreme Court case of *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*<sup>102</sup> In the *Chevron* decision, the Supreme Court established a process for reviewing the limits of agency regulations. First, the courts determine whether Congress clearly

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<sup>93</sup> *Id.*

<sup>94</sup> Letter from David P. Roe, et al., to Douglas H. Shulman, Commissioner, Internal Revenue Service (Nov. 4, 2011).

<sup>95</sup> *Id.*

<sup>96</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> Email from Cameron Arterton, Counsel, Office of Tax Legislative Counsel, U.S. Treasury Dep’t, to Jessica Hauser, Deputy Tax Legislative Counsel, U.S. Treasury Dep’t (Dec. 1, 2011 at time) (on file with Committee on Oversight and Government Reform) [hereinafter “Arterton”].

<sup>100</sup> Email from Jessica Hauser, Deputy Tax Legislative Counsel, U.S. Treasury Dep’t, to Cameron Arterton, Counsel, Office of Tax Legislative Counsel, Department of Treasury (Dec. 1, 2011) (on file with Committee on Oversight and Government Reform).

<sup>101</sup> Arterton, *supra* note 99.

<sup>102</sup> *Chevron U.S.A. Inc. v. Natural Resources Def. Council, Inc.*, 467 U.S. 837 (1984).

spoke to the issue in the statute or whether the statute is unclear or ambiguous. If the court determines that Congress did speak to the issue, or the statute is clear and unambiguous, the analysis ends at step one and the courts will defer to the statute.<sup>103</sup> Otherwise, courts generally defer to the agencies interpretation, provided the rule is consistent with the text of the statute.<sup>104</sup>

In the June 13, 2013, briefing, Ms. Arterton was unable to explain which provisions of PPACA created the “sufficient ambiguity” within the statute.<sup>105</sup> Both Mr. Dunham and Ms. Koch could not remember ever working on a previous rule where *Chevron* was discussed prior to the publication of the final rule.<sup>106</sup> Mr. Dunham further stated that considering *Chevron* prior to the promulgation of a final rule was very unusual.<sup>107</sup>

In February 2012, Treasury produced a memorandum outlining their reasoning behind allowing premium tax credits in federal exchanges. Treasury refuses to identify the author of this memo, despite repeated requests by the Committees.<sup>108</sup> According to the memo:

The term “established by a state” may be read as a restriction on the term “exchange” or it may be read as simply descriptive language. Interpreting the language as a restriction is inconsistent with the broad scheme of the ACA to increase health insurance availability. Denying a premium tax credit to taxpayers enrolled in a QHP through the fed exchange while allowing a credit to those enrolled through state exchanges would be an incongruous result and could not have been Congress’ intent. The term “established by a state” should be interpreted to encompass the federal exchange because under §1321 of the ACA, the federal exchange steps into the shoes of a state exchange if a state declines to establish an exchange or if a state’s establishment of the exchange is delayed. A conclusion that the language §36B(b)(2)(A) is descriptive and not restrictive is further supported by the language of §36B(f)(3), which imposes information reporting requirements on exchanges, including the federal exchanges, established under §1321(c) of the ACA.<sup>109</sup>

This single paragraph is the only written analysis between the publication of the proposed rule and the publication of the final rule from either IRS or Treasury regarding the decision to extend PPACA’s subsidies to individuals in federal exchanges.

On May 16, 2012, Ms. Arterton submitted the policy memo that accompanied the final rule to Ms. McMahon for her review. In the memo, Ms. Arterton reiterated the Administration’s justification behind the decision to allow subsidies for individuals in states with federal exchanges:

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<sup>103</sup> *Id.* at 843-44.

<sup>104</sup> *Id.* at 844-45.

<sup>105</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> The most recent request for the information on the author of the memo was an in-camera review of Treasury documents related to the Section 36B rulemaking on September 24, 2013.

<sup>109</sup> Memorandum, Pre-final rule legal analysis memo (Feb. 2012).

[T]he term “Exchange” refers to more than simply state established exchanges, we carefully considered the language of the statute and the legislative history and concluded that the better interpretation of Congressional intent was that premium tax credits should be available to taxpayers on any type of Exchange. For example, §36B(f)(3) provides that “Each exchange ... shall provide the following information to the Secretary and to the taxpayer with respect to any health plan provided through the Exchange...” The reference to §1321(c) is a reference to the section authorizing the federally-facilitated Exchange. There would be no reason for Congress to include – within the Code section that creates the premium tax credit – an obligation for a federally-facilitated Exchange to report data about enrollments to the Secretary unless the enrolling individuals were eligible for the premium tax credit.<sup>110</sup>

Despite receiving numerous comments, including those from Members of Congress, the evidence shows that Treasury failed to engage in a serious or thorough review of the issue between the publication of the proposed rule and the publication of the final rule. Rather, Treasury’s cursory review, which included discussions about whether *Chevron* would apply to its decision to allow the premium subsidies in federal exchanges, simply reiterated the Administration’s previous interpretation and did not even take into account reasons for why a plain text reading of the statute could preclude PPACA’s premium subsidies from being available in federal exchanges.

#### **V. Treasury’s Assistant Secretary for Tax Policy Mark Mazur Never Saw Any Documents Related to Treasury’s Interpretation Produced Prior to May 2012**

On January 16, 2014, Committee staff interviewed Mr. Mazur about his knowledge of the process that led to IRS and Treasury’s decision to allow PPACA’s premium subsidies in federal exchanges.<sup>111</sup> Despite the magnitude of the issue and Mr. Mazur’s October 12, 2012, letter to Chairman Issa, Mr. Mazur testified that he did not see any analyses produced by IRS or Treasury staff regarding the issue of whether the tax credits would be available in federal exchanges that was drafted prior to May 2012:

Q Have you seen any analyses produced by IRS or Treasury staff regarding the issue of whether the tax credits would be available in Federal exchanges?

A I am aware of the topic now and I have seen work that has been done recently. I am not aware of anything -- of seeing anything prior to May 2012 on that.

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<sup>110</sup> Memorandum from Cameron Arterton, Counsel, Office of Tax Legislative Counsel, U.S. Treasury Dep’t, to Emily McMahon, Deputy Assistant Sec’y, U.S. Treasury Dep’t, Pre-final rule clearance package (May 16, 2012).

<sup>111</sup> Interview with Mark Mazur, *supra* note 32.

Q Okay. So you can't recall seeing any analyses produced prior to May 2012 on this subject?

A Correct.<sup>112</sup>

Mr. Mazur could not recall basis for key statements within his October 12, 2012, letter about Treasury's interpretation:

Q In the letter, you wrote, "We interpreted the language in context and consistent with the purpose and structure of the statute as a whole." Do you recall your basis for that statement?

A I don't recall the basis for that, no.

Q Did you recall ever seeing any formal analysis that addressed whether the rule was consistent with the purpose and structure of the statute as a whole?

A When we put out regulations, we have an internal policy memo that goes to the Assistant Secretary, or Acting Assistant Secretary at the time. In the case of these regulations in May 2012, there would've been a policy memo for Emily McMahon that explained in detail the rationale for coming out to a particular place.

Q So you've reviewed that memo?

A I have seen that memo.<sup>113</sup>

The May 2012 policy memo, discussed in this report and referred to by Mr. Mazur, did not contain a detailed rationale for IRS and Treasury's decision to allow tax credits in federal exchanges. The fact that Mr. Mazur has *never* reviewed anything from *prior* to May 2012 specific to Treasury's interpretation to allow PPACA's tax subsidies in federal exchanges is consistent with the evidence obtained by the Committees, and discussed in depth in the remainder of the report, that IRS and Treasury failed to arrive at their interpretation of the statute through reasoned decision-making.

## **VI. Final Rule Provided No Evidence Supporting the Administration's Interpretation**

During the *in-camera* review of documents and communications on September 24, 2013, the Committee on Oversight and Government Reform discovered that early IRS drafts of the final 36B rule contained an explanation for the Administration's decision to allow tax credits in

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<sup>112</sup> *Id.*

<sup>113</sup> *Id.*



federal exchanges.<sup>114</sup> This explanation referenced a reporting requirement, added by the Health Care and Education Reconciliation Act, which required both state exchanges and federal exchanges to report information about the coverage they provided to Treasury. The Committee on Oversight and Government Reform also discovered during the September 24, 2013, document review that some IRS or Treasury employees recognized that the “apparently plain” language of the statute restricted PPACA’s tax credits to only state exchanges.<sup>115</sup> The draft final rule stated that agencies have broad discretion to reasonably interpret a regulation if the “apparently plain statutory language” is inconsistent with the purpose of the law.<sup>116</sup> This discussion was removed by Treasury officials from the text of the final rule draft sometime between May 1, 2012, and May 9, 2012.<sup>117</sup>

One of the later drafts of the final rule contained language that Treasury would not adopt the commenters’ suggestion that PPACA’s premium subsidies should be restricted to state established exchanges. This phrase was flagged by a reviewer (denoted as “comment LF4”) who asked if they could make the language stronger, suggesting that they “reject the comment rather than fail to adopt.”<sup>118</sup> While LF4’s suggested language did not make it into the final rule, the text was changed to read “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.”<sup>119</sup>

On May 23, 2012, Treasury released the 36B final rule.<sup>120</sup> This final rule stated the reason for IRS and Treasury’s decision that PPACA’s premium subsidies would not be restricted to individuals purchasing coverage in state exchanges:

Commentators disagreed on whether the language in section 36B(b)(2)(A) limits the availability of the premium tax credit only to taxpayers who enroll in qualified health plans on State Exchanges.

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

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<sup>114</sup> Review of Treasury Documents related to 36B Rulemaking (Sept. 24, 2013).

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* LF4 could refer to Liz Fowler, a key White House health care advisor. Several emails reviewed by the Committee show that Ms. Fowler was actively involved with the Administration’s defense of their interpretation of the rule.

<sup>119</sup> Review of Treasury Documents related to 36B Rulemaking (Sept. 24, 2013).

<sup>120</sup> Health Insurance Premium Tax Credit, 77 Fed. Reg. 30,378 (May 23, 2012), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf>.

proposed regulations because it is consistent with the language, purpose, and structure of section 36B and the Affordable Care Act as a whole.<sup>121</sup>

The one paragraph explanation in the final rule failed to cite *any* statutory provision or legislative history in support of Treasury’s interpretation.

## **VII. IRS Failed to Examine the Entire Statute**

In the October 12, 2012, letter to Oversight and Government Reform Committee Chairman Darrell Issa, Treasury’s Deputy Secretary for Tax Policy Mark Mazur wrote that PPACA lacked a discernible pattern with respect to how the law referenced exchanges. According to Mr. Mazur:

[T]hroughout the ACA, Congress refers to the exchanges as “exchanges,” “exchanges established by a state,” and “exchanges established under the ACA.” *There is no discernible pattern* that suggests Congress intended the particular language in section 36B(b)(2)(A) to limit the availability of the tax credit.<sup>122</sup>  
[emphasis added]

During the interviews between the Committees and the 36B Working Group, the Committees questioned how Treasury and IRS determined that there was no discernible pattern in the way Congress used “Exchange” in PPACA. At the June 13, 2013, briefing, Ms. Arterton told the Committees that she searched PPACA for references to the term “Exchange.” Ms. Koch, who was a key member of the 36B Working Group and a health care counsel in the Office of Chief Counsel, told the Committees that she searched PPACA for references to “Section 1311” and “Section 1321.” However, Ms. Arterton and Ms. Koch admitted to the Committees that neither of them made any attempt to categorize or organize the results of their search in any way to determine whether a pattern existed with PPACA.<sup>123</sup>

The Committees asked IRS and Treasury employees involved with drafting the 36B rule whether they considered how several sections of PPACA related to their interpretation. Many of these sections were outlined in Jonathan Adler and Michael Cannon’s law review article, *Taxation Without Representation: The Illegal IRS Rule to Expand Tax Credits Under the PPACA*,<sup>124</sup> and in CRS’s legal analysis of the issue.<sup>125</sup>

During the April 4, 2013, and June 13, 2013, briefings, the Committees asked the seven key IRS and Treasury employees whether they considered the use of the phrase “Exchange

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<sup>121</sup> *Id.*

<sup>122</sup> Letter from Mark J. Mazur, *supra* note 34.

<sup>123</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>124</sup> Adler & Cannon, *supra* note 2, at 120. Michael F. Cannon is the director of Health Policy Studies at the Cato Institute.

<sup>125</sup> Staman & Garvey, *supra* note 2.

established by the State under Section 1311” in Section 2001 of PPACA during the rulemaking process.<sup>126</sup> Section 2001 is the section of PPACA that expanded Medicaid to adults with incomes up to 138 percent of the federal poverty level. Within Section 2001 is a requirement that a state cannot reduce its current Medicaid eligibility level until an “Exchange established by the State under Section 1311” is operational.<sup>127</sup> This provision is another example of the law providing incentives to states. In this case, the state gains additional flexibility with their Medicaid program when they elect to establish an exchange. None of the IRS and Treasury employees interviewed could recall whether they reviewed this section as part of their analysis. Moreover, there is no evidence that IRS or Treasury reviewed this section prior to concluding that there was no discernible pattern in how PPACA referenced exchanges.

During the April 4, 2013, and June 13, 2013, briefings, Committee staff listed several other sections of PPACA that referenced “Exchange established by the State.”<sup>128</sup> None of the seven IRS and Treasury employees involved with the 36B regulation interviewed by the Committees could recall whether IRS or Treasury considered any of these sections in their review of the law. IRS and Treasury have been unable to provide any evidence that they reviewed each section in PPACA that referenced “Exchange established by the State” before concluding that there was no discernible pattern in the way that Congress used Exchange.

Section 1421 of PPACA authorized tax credits for small businesses that offer coverage through an Exchange.<sup>129</sup> When drafting section 1421, Congress used the more inclusive language of “an Exchange” rather than using the language “Established by the State under Section 1311.”<sup>130</sup> The text of this section implies that the small business tax credits would be available in both federal and state exchanges. None of the seven IRS and Treasury employees interviewed by the Committees were aware of this distinction, and none could recall considering Section 1421’s applicability to their decision that PPACA’s subsidies would be available to individuals in federal exchanges.<sup>131</sup>

Section 1323, added by the Health Care and Education Reconciliation Act that amended PPACA, explicitly authorized premium subsidies in territorial exchanges.<sup>132</sup> The Committees asked the 36B working group whether they had considered that Section 1323 had explicitly authorized subsidies in territorial exchanges. The IRS and Treasury employees interviewed by the Committees were unaware of this section of PPACA and they could not recall considering the language within Section 1323 during their drafting of the regulation. IRS and Treasury

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<sup>126</sup> See PPACA, Pub. L. No. 111-148, § 2001, 124 Stat. 119, 271-79 (2010).

<sup>127</sup> *Id.* § 2001(b).

<sup>128</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5. These sections include PPACA Sections 1401, 2001, 2101 and 2201.

<sup>129</sup> I.R.C. §45R (2012).

<sup>130</sup> *Id.* (“An arrangement is described in this paragraph if it requires an eligible small employer to make a nonelective contribution on behalf of each employee who enrolls in a qualified health plan offered to employees by the employer through an exchange in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the qualified health plan.”).

<sup>131</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>132</sup> Health Care and Education Reconciliation Act, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

employees also told the Committees that they never discussed the fact that Congress could have authorized exchange subsidies in federal exchanges through reconciliation, just as they did with territories.<sup>133</sup>

### **VIII. Treasury Failed to Consider Whether Congress Structured the Premium Subsidies to Elicit State Cooperation**

As discussed earlier, the federal government is generally prohibited from forcing states to implement federal programs or regulations. This is known as the federal government commandeering the states. For example, while Section 1311 stated “[e]ach state *shall*... establish an ... Exchange,” (emphasis added) the federal government could not literally force individual states to create exchanges.<sup>134</sup>

Prominent legal scholars offered several ideas for how PPACA could be drafted to avoid a commandeering problem. In January 2009, Timothy Jost, an outspoken PPACA advocate who in March 2010 was invited to attend the signing ceremony for PPACA, was one such legal scholar.<sup>135</sup> Professor Jost, who has testified about the law at several Congressional hearings, published an article entitled *Health Insurance Exchanges: Legal Issues*, in a Georgetown University legal journal.<sup>136</sup> This article was published during the beginning of the debate over legislation that would ultimately become PPACA. In the article, Professor Jost discussed ways around the commandeering problem:

Congress could invite state participation in a federal program, and provide a federal fallback program to administer exchanges in states that refused to establish complying exchanges. Alternatively it could exercise its Constitutional authority to spend money for the public welfare (the “spending power”), *either by offering tax subsidies for insurance only in states that complied with federal requirements* (as it has done with respect to tax subsidies for health savings accounts) or by offering explicit payments to states that establish exchanges conforming to federal requirements.<sup>137</sup> [emphasis added]

In a 2012 paper in the law journal *Health Matrix*, Michael Cannon and Jonathan Adler point out that conditioning tax credits on states creating exchanges is not only consistent with PPACA, it was a necessary feature aimed at providing states with incentives to create exchanges.<sup>138</sup> According to Mr. Cannon and Professor Adler:

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<sup>133</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>134</sup> PPACA, Pub. L. No. 111-148, § 1311(c), 124 Stat. 119, 174-75 (2010) (Each State shall, not later than January 1, 2014, establish an American Health Benefit Exchange (referred to in this title as an “Exchange”) for the State).

<sup>135</sup> Press Release, Washington and Lee University School of Law, W&L Law’s Jost Invited to Health Care Bill Signing Ceremony (Mar. 23, 2010), <http://law.wlu.edu/news/storydetail.asp?id=758>.

<sup>136</sup> Jost, *supra* note 7.

<sup>137</sup> *Id.*

<sup>138</sup> Adler & Cannon, *supra* note 2, at 121, 134.

The language in Sections 1401 and 1402 restricting credits and subsidies to state-created Exchanges is more than just consistent with the rest of the Act. It is integral to Section 1311's directive that states "shall" create an Exchange. Because it likely creates a larger financial incentive than the Medicaid "maintenance of effort" requirement, it is the primary sanction imposed on states that do not establish Exchanges. It thus animates Section 1311's "shall." To ignore it as the IRS has would sap that directive of most of its force.<sup>139</sup>

At the April 4, 2013, briefing, Emily McMahon, the Deputy Assistant Secretary for Tax Policy at the Treasury Department, was unfamiliar with the term "commandeering problem."<sup>140</sup> In both the April 4, 2013, and the June 13, 2013, briefings, none of the officials working on the rule could recall anyone raising the commandeering problem and its applicability to its rulemaking in this area.<sup>141</sup> Furthermore, none of the seven IRS and Treasury employees interviewed by the Committees were aware of any internal discussion within IRS or Treasury, prior to the issuance of the final rule, that making tax credits conditional on state exchanges might be an incentive put in the law for states to create their own exchanges.<sup>142</sup> Since the commandeering problem was discussed broadly prior to the passage of PPACA and since the commandeering problem was prominent in the multi-state challenge to the law's Medicaid-expansion mandate, the failure of IRS and Treasury officials to consider the issue during the 36B rulemaking is additional evidence of the Administration's failure to engage in reasoned decision-making prior to deciding that PPACA's premium subsidies would be available in federal exchanges. Moreover, Ms. McMahon testified that she could not recall whether the withdrawal of Medicaid funding was ever discussed by the IRS or Treasury during their analysis of whether the law permitted premium subsidies in federal exchanges.<sup>143</sup> Finally, none of the seven key employees from IRS and Treasury interviewed by the Committee had seen Timothy Jost's January 2009 article prior to being shown it by Committee staff.

## **IX. Treasury Failed to Consider PPACA's Appropriate Legislative History**

The House passed its own version of a health care law on November 7, 2009, and the Senate passed PPACA on December 24, 2009.<sup>144</sup> There were significant disagreements between the House and the Senate about many provisions within their separate bills. One major difference was that the House bill opted for a single federal health insurance exchange while

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<sup>139</sup> *Id.* at 153.

<sup>140</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>141</sup> *Id.*; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>142</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>143</sup> Statement of Emily McMahon, *supra* note 45.

<sup>144</sup> Dana Bash, et al., *House passes health care reform bill*, CNN, Nov. 8, 2009, <http://www.cnn.com/2009/POLITICS/11/07/health.care/>; Shailagh Murray and Lori Montgomery, *Senate passes health-care bill, now must reconcile it with House*, WASH. POST, Dec. 25, 2009, [http://articles.washingtonpost.com/2009-12-25/politics/36888650\\_1\\_senate-democrats-senate-clerk-health-insurance-reform](http://articles.washingtonpost.com/2009-12-25/politics/36888650_1_senate-democrats-senate-clerk-health-insurance-reform).

PPACA relied on state-based health insurance exchanges.<sup>145</sup> After the Senate's passage of PPACA, supporters planned to create a Conference Committee to reconcile the differences between the two bills and send a compromise bill to each body for a final vote.<sup>146</sup>

The strategy to address the bills' differences through a Conference Committee changed with Scott Brown's election to the U.S. Senate from Massachusetts on January 19, 2010.<sup>147</sup> Scott Brown's election was significant because he became the 41<sup>st</sup> vote against cloture on a conference report. This presented the law's supporters in the House with a choice - either pass PPACA with minor changes made through budget reconciliation or do not pass a bill at all.<sup>148</sup>

The House decided to forego their differences with PPACA by passing the exact same bill adopted in the Senate. This meant adopting provisions that concerned many House members who preferred the House bill's approach. For example, PPACA includes a provision that would require Members of Congress and their staff to enter the health insurance exchanges created by the law. Many House members who supported PPACA in general complained about this provision, but as Congresswoman Diana DeGette, noted, "We had to take the Senate version of the health care bill."<sup>149</sup> Since the House of Representatives accepted PPACA without any changes, except for those made by reconciliation, PPACA, not the House bill, reflects and embodies congressional intent. Therefore the only relevant legislative history in the House of Representatives would be remarks that House members made about PPACA, generally between Senate passage on December 24, 2009 and House passage on March 21, 2010.<sup>150</sup>

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<sup>145</sup> Julie Rovner, *House, Senate View Health Exchanges Differently*, NPR, Jan. 12, 2010, <http://www.npr.org/templates/story/story.php?storyId=122476051> [hereinafter "Rovner"].

<sup>146</sup> Kathy Kiely, *Senate passes health care bill*, USA TODAY, Dec. 24, 2009, [http://usatoday30.usatoday.com/news/washington/2009-12-23-health-care\\_N.htm](http://usatoday30.usatoday.com/news/washington/2009-12-23-health-care_N.htm) ("The Senate vote now sends the legislation to a conference committee, where Democratic leaders will try to reconcile differences between House and Senate bills...").

<sup>147</sup> *GOP's Scott Brown Wins Mass. Senate Race*, CBS NEWS, Jan. 19, 2010, [http://www.cbsnews.com/2100-250\\_162-6117658.html](http://www.cbsnews.com/2100-250_162-6117658.html).

<sup>148</sup> Many Democratic members of the House of Representative had serious concerns with the bill passed by the Senate. On January 22, 2010, Timothy Jost and dozens of other left-leaning health policy scholars sent a letter to the House leadership pleading them to accept the Senate bill as is. According to the letter, "These bills are imperfect. Yet they represent a huge step forward in creating a more humane, effective, and sustainable health care system for every American. We have come further than we have ever come before. Only two steps remain. *The House must adopt the Senate bill, and the President must sign it.*" See Harold Pollack, *47 (Now 51) Health Policy Experts (Including Me) Say "Sign the Senate bill."* NEW REPUBLIC, Jan. 22, 2010, <http://www.newrepublic.com/blog/the-treatment/47-health-policy-experts-including-me-say-sign-the-senate-bill> (emphasis added).

<sup>149</sup> Robert Pear, *Wrinkle in Health Law Vexes Lawmakers' Aides*, N.Y. TIMES, (July 29, 2013), <http://www.nytimes.com/2013/07/30/us/politics/wrinkle-in-health-law-vexes-lawmakers-aides.html?pagewanted=all&r=0>.

<sup>150</sup> Shailagh Murray and Lori Montgomery, *House passes health-care reform bill without Republican votes*, WASH. POST, Mar. 22, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/03/21/AR2010032100943.html?sid=ST2010032201830>. The reconciliation bill would be passed a couple days later.

### *Treasury Relied on Statements Made by House Members About Bills Other Than PPACA*

The Committees learned that after the proposed rule was issued and IRS's interpretation became scrutinized by Members of Congress and outside legal experts, Ms. Arterton was tasked with reviewing the law's legislative history. Ms. Arterton told the Committees that she never produced a written review of any kind related to her search of the law's legislative history. In fact, it appears no one at IRS or Treasury ever produced a written analysis of the legislative history with respect to whether tax credits should be authorized in federal exchanges. Ms. Arterton told the Committees that she looked at statements from House members made prior to the passage of PPACA on December 24, 2009, during her cursory review of the legislative history.<sup>151</sup>

At a hearing before the Committee on Oversight and Government Reform, Emily McMahon confirmed that "the prior bills were taken into account."<sup>152</sup> By considering statements from House members about bills other than PPACA, Ms. Arterton's review of the legislative history imputed congressional intent from bills that did not and could not pass the Congress as a whole.

### *Treasury Did Not Consider the Senate's Preference for State Exchanges*

The only substantive review of the legislative history on this issue appears to have been conducted by Mr. Cannon and Professor Adler for their law review article. Mr. Cannon and Professor Adler conducted an exhaustive study of the Senate sections of the Congressional Record between June 2009 and the final passage of PPACA, as well as the House sections of the Congressional record between Senate passage of PPACA (on December 24, 2009) and final passage on March 21, 2010. According to Mr. Cannon and Professor Adler's review of the legislative history, the Senate had a clear preference for state-based Exchanges.<sup>153</sup>

There were several reasons why the Senate bill relied on exchanges established by states. First, given unified Republican opposition, Senate Majority Leader Harry Reid needed all 60 Democratic Senators to support the legislation. Former Democratic Senator Ben Nelson of Nebraska was critical of the House of Representatives' approach, stating that "[t]he national exchange is unnecessary and I wouldn't support something that would start us down the road of federal regulation of insurance and a single-payer plan."<sup>154</sup> Moderate Democratic senators, like former Senator Nelson, were needed to obtain the 60 votes to break a Republican filibuster. Second, the approach of using state-based exchanges was viewed by Senate Democrats as an effective counter to the argument that PPACA was a federal takeover of health care.<sup>155</sup>

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<sup>151</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>152</sup> Statement of Emily McMahon, *supra* note 45.

<sup>153</sup> Adler & Cannon, *supra* note 2, at 142.

<sup>154</sup> See Carrie Budoff Brown, *Nelson: National Exchange a Dealbreaker*, POLITICO, Jan. 25, 2010, [http://www.politico.com/livepulse/0110/Nelson\\_National\\_exchange\\_a\\_dealbreaker.html](http://www.politico.com/livepulse/0110/Nelson_National_exchange_a_dealbreaker.html).

<sup>155</sup> Senate Democratic Policy Comm. Fact Check: Responding to Opponents of Health Insurance Reform (Sept. 21, 2009), available at <http://www.dpc.senate.gov/docs/fs-111-1-120.pdf> ("There is no government takeover or control

Both conservative and liberal health policy experts also favored a state-based exchange approach. In May 2009, Dr. Len Nichols, Director of Health Policy at the liberal New America Foundation, testified before the Senate Finance Committee:

It is not necessary (or wise) to have one national exchange/marketplace . . . . Insurance market rules governing the new marketplaces should be uniform across the country, but the exchanges themselves could be organized on a national, state, or sub-state level. It is important to remember that all health markets (like politics) are local. Competing against Kaiser in San Francisco or Group Health in Seattle is different than competing against Blue Cross of Arkansas in Little Rock. Exchange managers and oversight boards can and should bring local expertise and flexibility to the overall federal superstructure.”<sup>156</sup>

Stuart Butler, Vice President of Domestic Policy for the conservative Heritage Foundation, agreed with Dr. Nichols, testifying that “[t]he solution would be for the federal government to do two things. First, set out broad objectives for exchanges, and allow states to propose designs for state or regional exchanges to be certified by the federal government.”<sup>157</sup>

In addition to the evidence from the Senate debate, the Senate’s preference for state established exchanges within the law seems apparent in Section 1311 of PPACA, which authorizes essentially unlimited funds for states to create exchanges but allocates no equivalent funds for the creation of federal exchanges.<sup>158</sup> During both the April 4, 2013, and the June 13, 2013, briefings, the seven IRS and Treasury employees stated they did not consider the Senate’s preference for state exchanges during the development of the rule.<sup>159</sup> At a hearing before the House Committee on Oversight and Government Reform, Ms. McMahon testified that she did not recall whether Treasury considered that Congress created large financial incentives, such as exchange establishment grants to cover the cost of states creating exchanges and that Congress failed to create any specific funding for the creation of federal exchanges, during Treasury’s consideration of this issue.<sup>160</sup> All IRS and Treasury employees interviewed by the Committee also stated that they did not remember whether they considered the fact that Congress authorized grants for states to create exchanges but neglected to provide equivalent funds for federal

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of health care in any senate health insurance reform legislation . . . *All the health insurance exchanges, which will create choice and competition for Americans’ business in health care, are run by states.*”) (emphasis added).

<sup>156</sup> *Roundtable Discussion on Expanding Health Care Coverage: Before the S. Comm on Finance, 111th Cong.* (May 5, 2009) (testimony of Len M. Nichols, Director, Center for Health Policy Research and Ethics, George Mason Univ.).

<sup>157</sup> *Roundtable Discussion on Expanding Health Care Coverage: Before the S. Comm on Finance, 111th Cong.* (May 5, 2009) (testimony of Stuart Butler, Director of the Center for Policy Innovation, Heritage Found.).

<sup>158</sup> See PPACA, Pub. L. 111-148, §§1311, 1321, 124 Stat. 119, 173-181, 186-87 (2010). Section 1311 offers unlimited funds for states to create exchanges. Section 1321 authorizes the Secretary of HHS to create a federal exchange in states that do not create their own. Unlike section 1311, this section does not contain a provision authorizing funds for federal exchanges.

<sup>159</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>160</sup> Statement of Emily McMahon, *supra* note 45.



exchanges during their review of whether state exchanges and federal exchanges were equivalent.<sup>161</sup>

### *Treasury's Review of the Legislative History Was Incomplete*

Treasury's review of the legislative history also missed several important parts of the Congressional debate. For example, the Senate Finance Committee needed some form of jurisdictional hook in order to consider legislation regulating health insurance and directing states to create exchanges – activities that lay outside the Finance Committee's jurisdiction. During one mark-up session, then-Senator John Ensign asked Chairman Max Baucus how the Finance Committee had jurisdiction to direct states to create exchanges. Chairman Baucus responded that there were “conditions to participate in the Exchange.”<sup>162</sup> Baucus also noted that an “exchange is essentially tax credits,” which are in the jurisdiction of the Finance Committee.<sup>163</sup> Conditioning premium tax credits on states creating exchanges thereby gave the Finance Committee jurisdiction to direct states to create exchanges. In the June 13, 2013, briefing, Treasury and IRS officials said that they did not consider Senator Baucus' statement prior to the promulgation of the final rule.<sup>164</sup> Moreover, at the Committee hearing on July 31, 2013, Ms. McMahon was not prepared to discuss PPACA's antecedent bills and how they conditioned premium tax credits on state compliance.<sup>165</sup> She indicated that she would take the question back and provide the Committee with an answer, but she failed to follow up.<sup>166</sup>

Furthermore, the Committees learned that Treasury's cursory review of the legislative history missed a relevant communication from 11 Members of the Texas delegation of the House of Representatives to President Obama and House leadership dated January 11, 2010. The Texas Members were concerned with PPACA's reliance on states to establish and operate exchanges, and they argued for adopting a single, federal exchange.<sup>167</sup> In the letter, the representatives from Texas stated that the Senate bill “relies on states with indifferent state leadership that are unwilling or unable to administer and properly regulate a health insurance marketplace.”<sup>168</sup> They were concerned that due to PPACA's approach to exchanges, “millions of people will be left no better off than before Congress acted.”<sup>169</sup> This letter is a crucial part of PPACA's legislative history. It shows that rank-and-file House members and House leaders were aware that PPACA provided certain benefits contingent on state cooperation. At both the April 4, 2013, and June

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<sup>161</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>162</sup> *Executive Committee Meeting to Consider Health Care Reform: Before the S. Comm. on Finance*, 111th Cong. 326 (2009), available at <http://www.finance.senate.gov/hearings/hearing/download/?id=c6a0c668-37d9-4955-861c-50959b0a8392>.

<sup>163</sup> *Id.*

<sup>164</sup> June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>165</sup> Statement of Emily McMahon, *supra* note 45.

<sup>166</sup> *Id.*

<sup>167</sup> Rovner, *supra* note 145.

<sup>168</sup> Letter from Rep. Lloyd Doggett, *supra* note 8.

<sup>169</sup> *Id.*

13, 2013 briefings, all seven IRS and Treasury employees stated that they were unaware of this letter when presented with it by the Committees.<sup>170</sup>

Following its inadequate review of the legislative history, Treasury wrote in the final rule that “the relevant legislative history does not demonstrate that Congress *intended to limit the premium tax credit to State Exchanges*. [emphasis added].”<sup>171</sup> In the June 13, 2013, briefing, Ms. Arterton told the Committees that the legislative history was inconclusive, echoing then-Deputy General Counsel for Treasury Chris Weideman’s statement during a November 2, 2012, briefing.<sup>172</sup> On November 2, 2012, Mr. Weideman remarked that IRS and Treasury concluded that there was a lack of evidence in PPACA’s legislative history to support its interpretation and that there was also a lack of evidence in the legislative history that contradicted their interpretation.

## **X. Conclusion**

PPACA tasked states to establish health insurance exchanges. The law contained numerous incentives for these states to create their own exchanges, including grants for states to establish exchanges and subsidies to assist residents of these states in purchasing insurance through the exchanges. As the non-partisan Congressional Research Service legal analysis noted, the plain language of the statute does not appear to authorize PPACA’s premium tax credits or the resulting penalties in states that elect not to establish exchanges.<sup>173</sup> This feature of PPACA fits a pattern of the law not living up to the expectations of many of its supporters. The Administration’s decision to extend those provisions to states that elect not to establish exchanges also fits a pattern of extralegal actions taken by the Administration to address flaws in PPACA without going through Congress.

IRS and Treasury officials told the Committees that despite a lack of clear statutory authority, the issue of whether IRS could issue premium subsidies and impose the resulting penalties in the states that have elected not to establish exchanges was not a key issue for consideration prior to the issuance of the proposed 36B rule. IRS and Treasury employees working on the 36B rule told the Committees that they did not spend a substantive amount of time considering whether the law authorized premium subsidies in federal exchanges, and this is further supported by the fact that the issue was excluded from the list of significant issues and considerations within the policy memo that accompanied the proposed rule.

IRS’s and Treasury’s deviation from the plain text of the statute in the proposed rule resulted in numerous comments from individuals during the notice and comment period and

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<sup>170</sup> April 2013 Briefing from IRS & Treasury Officials, *supra* note 5; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>171</sup> Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, 77 Fed. Reg. 30,378 (May 23, 2012), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-12421.pdf>.

<sup>172</sup> November 2012 Briefing from IRS & Treasury Officials, *supra* note 29; June 2013 Briefing from IRS & Treasury Officials, *supra* note 5.

<sup>173</sup> Staman & Garvey, *supra* note 2.

letters from Members of Congress noting that the Administration did not have the authority to provide subsidies in federal exchanges. Although Treasury claims it took a “fresh look” at this issue after the proposed rule, Treasury lacks evidence to support its claim that it engaged in a serious and thorough review of whether the PPACA authorizes premium subsidies in federal exchanges. This report outlined many weaknesses with Treasury’s review, including the failure of anyone at IRS or Treasury to categorize or organize the way PPACA references the term “exchange” and the failure of anyone at IRS or Treasury to conduct an adequate review of the legislative history.

The decision by IRS and Treasury to extend PPACA’s premium subsidies to federal exchanges beyond the apparently plain statutory language that makes these subsidies available only in state-established exchanges is extremely consequential. First, since many states elected not to establish their own exchanges, IRS and Treasury’s interpretation significantly increases federal taxes and spending beyond the apparently plain statutory language that makes these subsidies available only in state-established exchanges. Second, since the employer mandate tax penalties are linked to the availability of these subsidies, IRS and Treasury’s interpretation subjects employers in states that elected not to establish an exchange to penalties under the PPACA. The Committees’ investigation, which focused on the rulemaking process and not the merits of IRS and Treasury’s interpretation, has concluded that despite claims to the contrary, neither IRS nor Treasury engaged in reasoned decision-making of this important issue prior to issuing the final rule that extended PPACA’s premium subsidies to federal exchanges. While prior to the proposed rule IRS and Treasury’s failure to do so was largely due to other pressing priorities with the 36B regulation, IRS and Treasury’s failure to engage in reasoned decision-making in the period between the proposed rule and the final rule is inexcusable and significantly calls into question the merits of IRS and Treasury’s interpretation. It is clear that PPACA has failed to live up to the expectations of many of its supporters. However, Congress is responsible for addressing the law’s shortcomings through legislation, not federal agencies through the rulemaking process.