U.S. Senate Committee on the Judiciary, Subcommittee on Oversight, Agency Action, Federal Rights and Federal Courts, hearing on the Internal Revenue Service final rule implementing the premium-assistance tax credit provisions of the Patient Protection and Affordable Care Act of 2010, testimony of Michael F. Cannon, director of health policy studies, Cato Institute[1]

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Chairman Cruz, Ranking Member Coons, and members of the Committee, thank you for the opportunity to discuss what we know about how the Internal Revenue Service developed its Health Insurance Premium Tax Credit rule of May 23, 2012, implementing the premium-assistance tax credit provisions of the Patient Protection and Affordable Care Act of 2010.[2]

Two federal courts have found that rule expanded the reach of the ACA's employer mandate beyond the clear limits Congress imposed on the agency's authority.[3] According to those courts, the IRS is unlawfully subjecting more than 250,000 employers and 57 million workers to that tax.[4] One of those workers is Kevin Pace, a jazz musician and music teacher in Virginia. According to the *Washington Post*, Pace lost $8,000 of income in the first year the IRS imposed that mandate on his employer.[5] According to one estimate, this illegal tax reduces a typical worker's income by nearly $1,000 and has eliminated nearly a quarter-million jobs.[6]

Those federal courts likewise found the IRS rule unlawfully expanded the reach of the ACA's individual mandate. As a result, the IRS is currently subjecting an estimated 11 million taxpayers to an illegal tax averaging $1,200 per taxpayer.[7]

Whatever good the IRS hopes to accomplish with those funds is irrelevant. The authority to levy taxes and to spend federal dollars rests with Congress alone.[8]

In *King v. Burwell*, four Virginia taxpayers allege the IRS's tax-credit rule is subjecting them, Kevin Pace, and 57 million other Americans to illegal taxes.[9] The Supreme Court heard oral arguments in March and will likely rule later this month. A ruling for the challengers would invalidate the rule, free more than 57 million Americans from illegal taxes, create an estimated 237,000 new jobs, and increase affected workers' earnings by nearly $1,000.[10]

The IRS's "Forced" Interpretation of the ACA

The IRS rule is unlawful because it contradicts the clear and unambiguous language of the ACA. The ACA authorizes premium subsidies (nominally, tax credits) only "through an Exchange established by the State under section 1311 of the Patient Protection and Affordable Care Act."[11] The availability of tax credits triggers penalties under the ACA's individual and employer mandates, such that if credits are not available, the individual mandate's reach is dramatically curtailed and the employer mandate ceases to operate entirely.[12]

The IRS rule purports to authorize subsidies in health-insurance Exchanges established by the federal government under Section 1321. The government argued before the Supreme Court, "The phrase 'Exchange established by the State under Section 18031' is a term of art that includes an Exchange established for the State by HHS." At a minimum, the government argued, the ACA is ambiguous on this question and the IRS's interpretation is reasonable.[13] But as Harvard law professor Noah Feldman explains:

> The uncomfortable truth (for liberals, at least) is that [*King v. Burwell*] arises from a piece of statutory language that on its face explicitly says that tax subsidies are only available for health insurance purchased on an exchange "established by the state."
>
> Liberals have tried to explain why, correctly interpreted, this language really means "established by the state or the federal government on the state's behalf." But their theories seem forced.[14]

My coauthor Jonathan H. Adler and I have written at length about how neither the ACA nor its legislative history provide any support for—and indeed squarely foreclose—the interpretation embodied in the IRS rule.[15]

How Did the IRS Reach Its Interpretation?

Exactly how the IRS came to interpret the ACA in this manner, however, remains a mystery. In the remainder of my testimony, I will discuss the troubling picture that emerges from what little we know about how the IRS developed this rule, and why we know so little.

1. The available evidence suggests IRS officials recognized the ACA did not give them the authority to impose these taxes.

Treasury and IRS officials permitted investigators from two House committees to interview officials involved in the developing the rule, and granted them brief access (see below) to certain documents.[16]

Investigators found that the IRS's draft rule originally included the statutory language restricting tax credits to Exchanges "established by the State," but IRS officials deleted it and inserted broader language when approached by a political appointee at the Treasury Department. In March 2011, Deputy Assistant Treasury Secretary for Tax Policy Emily McMahon read an article[17] in which an ACA critic discussed how the Act offers tax credits only in states that establish Exchanges. According to one Treasury Department attorney, McMahon approached IRS officials and inquired whether this was "a glitch in the law we needed to worry about." Investigators reported:

> 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." 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.[18]

As a result, when the IRS issued its proposed rule on August 17, 2011, it provided that "a taxpayer is eligible for the credit" if she purchases coverage "through an Exchange established under section 1311 or 1321."[19]

The timing and content of these changes is significant. The deletion of the phrase "established by the State" suggests IRS officials knew this language posed an obstacle to offering tax credits in federal Exchanges. If it did not, there would have been no reason to delete it. The inclusion of the phrase "or 1321" suggests IRS officials saw a difference between Exchanges established by States under Section 1311 and Exchanges established by the federal government under Section 1321. (As discussed below, these elements of the administrative record contradict key arguments the government made before the

Supreme Court in *King v. Burwell*.) The timing of these changes raises questions about whether the agency discarded part of the statute for political reasons.

Investigators reviewed a March 25, 2011, e-mail in which Treasury and IRS officials described the lack of authorization for subsidies in federal Exchanges as a "drafting oversight"; noted the lack of any statutory language deeming federal Exchanges to established by the State in which they operate; and suggested a regulatory work-around.[20] Each of these aspects suggests IRS officials knew the ACA did not allow them to do what they sought to do.

Investigators reported that a draft of the final rule claimed agencies have the power to override "apparently plain statutory language" if that language is inconsistent with the agency's understanding of the purpose of the law. While agency officials dropped that discussion from the final rule shortly before release, its appearance suggests IRS officials recognized the plain meaning of the relevant provision.[21]

"In the end," the *Washington Post* reports, "the Treasury and IRS officials who wrote the rules adopted the more expansive reading of the law — allowing subsidies for all marketplaces — because they concluded this was required for the new health-care initiative to succeed, according to current and former agency officials and documents they provided to congressional investigators."[22] This admission suggests IRS officials consciously elevated the political goal of helping the ACA succeed over a duty to implement the law according to the terms specified by Congress.

2. Treasury and IRS officials performed little or no analysis of the ACA and its legislative history, used legislation rejected by Congress to support their theory of congressional intent, and failed to consider important dimensions of this issue.

Treasury and IRS officials were unable to provide investigators with any written record showing they had actually researched the ACA or its legislative history. Indeed, the agencies' correspondence suggests it did not read the statute very closely. In an October 2012 letter to Congress, Assistant Treasury Secretary Mark Mazur claimed the ACA contained "no discernible pattern that suggests Congress intended the particular language of section 36B(b)(2)(A) to limit the availability of the tax credit." Mazur ignored (or was unaware) that section 36B contains a second explicit passage and seven cross-references limiting tax-credit eligibility to those who enroll in coverage "through an Exchange established by the State"—a discernible pattern in itself.[23]

Agency officials admitted that, in attempting to ascertain Congress's intent, they relied on statements House members made about the health care bill that passed the House in 2009, but that Congress ultimately rejected in early 2010.[24] Such statements cannot represent congressional intent, because Congress rejected that bill's approach. In particular, Congress rejected the House bill's provision creating full equivalence between state-established and federal Exchanges.

Investigators found that the IRS never considered that the ACA's authors had a clear preference for state-run Exchanges; never considered that Congress might have conditioned tax credits on states' establishing Exchanges as a way of inducing states to implement this part of the law; never considered that a leading health-law scholar proposed conditioning premium subsidies on states' establishing Exchanges in early 2009;[25] never considered that another leading Senate bill also conditioned Exchange subsidies on state cooperation;[26] and never considered that House Democrats complained that states that refused to establish Exchanges would prevent their residents from receiving "any benefit" from the ACA.[27]

3. The IRS's proposal to implement these taxes and subsidies in federal-Exchange states met immediate and sustained criticism.

Within days of the IRS unveiling its proposed tax-credit rule on August 17, 2011, academics noted the IRS's interpretation is contrary to law.[28] Citizens challenged the IRS's proposed rule during the notice-and-comment period.[29] Beginning in 2011, members of Congress complained the IRS's interpretation is illegal, demanded the agency reverse its proposed rule, and demanded all documents and communications relating to the development of the proposed rule.[30] Three and a half years later, Congress is still waiting for the IRS to honor that request for documents.

4. The administrative record offers no statutory support for or substantive explanation of the IRS's decision to ignore the plain meaning of "through an Exchange established by the State."

The IRS's final rule, issued May 23, 2012, contained only a one-paragraph explanation of the agency's decision to implement the disputed taxes and subsidies in states with federal 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 proposed regulations because it is consistent with the language, purpose, and structure of section 36B and the Affordable Care Act as a whole.[31]

This paragraph constitutes the agency's entire explanation for its decision in the administrative record. It fails to include, to account for, or even to acknowledge the only statutory language—"through an Exchange established by the State"—that speaks directly to the question presented. It does not even identify the "statutory language," or the "language, purpose, and structure," or the "relevant" legislative history upon which the agency supposedly relied. Indeed, the IRS was so vague about its reasoning, it avoided claiming either that it believes the ACA plainly authorizes tax credits in federal Exchanges, or that the Act is ambiguous on this question.

5. The administrative record contradicts arguments the government offered before the Supreme Court, and reveals those arguments to be post-hoc rationalizations.

When *King v. Burwell* reached the Supreme Court, the government reprised its argument that federal Exchanges are Section 1311 Exchanges, and unveiled a new argument: "The phrase 'Exchange established by the State under Section [1311]' is a term of art that includes an Exchange established for the State by HHS."[32] The available record shows IRS officials did not consider that phrase to be a term of art, and did not consider Section 1321 Exchanges to be established under Section 1311.

The facts that the IRS dropped the phrase "established by the State" from its draft regulations in March 2011; that IRS commissioner Douglas Shulman testified before Congress that the ACA contains "contradictory language" on this question;[33] and that IRS officials developing the rule researched how "tension/conflict between two statutory provisions" can trigger judicial deference to an agency's reasonable interpretation of a statute[34] all demonstrate that IRS officials recognized that phrase is not a

"term of art" that encompasses federal Exchanges. If it were, there would be no need to delete that phrase from the rule, or claim it is in tension with other parts of the statute.

Likewise, the fact that the IRS specified that tax credits would be available "through an Exchange established under section 1311 or 1321" demonstrates the agency did not interpret the statute as defining Section 1321 Exchanges as having been established under Section 1311.[35] If it did, there would have been no reason to list Section 1321 Exchanges separately.

6. The IRS has attempted to hide its actions and its reasoning from congressional and public scrutiny.

According to the *Washington Post*:

> The Treasury and IRS team writing the regulations recognized that the environment was becoming highly charged…Discussions intensified inside Treasury and the IRS over how to show that the government had considered the opponents' views but not draw media attention to the debate over subsidies, former officials recalled. "The overriding concern was not generating negative news stories," one former official said.[36]

That concern appears to have prevailed over reasoned decision-making and accountability.

It continues to do so. In December 2011, Senate Finance Committee ranking member Orrin Hatch wrote the Secretary of the Treasury to protest the IRS's proposed rule, to ask the agencies to reverse the rule, and to request "any correspondence (including emails, memoranda, written notes, and electronic documents) addressing your agencies' legal authority to issue a regulation that expands the section 36B Health Insurance Premium Tax Credit so as to be available for participation in Federally-facilitated Exchanges."[37] In September 2014, the House Committee on Oversight and Government Reform issued a subpoena "to compel the Treasury Department to produce the documents that will answer the Committee's outstanding questions."[38] Treasury and the IRS continue to ignore both requests. The agencies' lack of transparency is withholding crucial information from Congress and the public.

It is important to note that the only reason we know the IRS dropped the statutory requirement "through an Exchange established by the State" from its draft regulations is because, after much persistence by House investigators, Treasury officials let them sit in the room with some documents. Investigators were not allowed to take the documents with them. They couldn't make copies. They couldn't take pictures. They couldn't take notes. They could only look at the documents, then leave the room to scribble down as many notes as they could remember. This is not how a democracy does business.

Conclusion

The IRS rule at issue in *King v. Burwell* does not appear to be an isolated incident, but part of a pattern. My co-panelist University of Iowa law professor Andy Grewal has discovered three other ways the IRS expanded eligibility for tax credits, and expanded the reach of the taxes they trigger, beyond the clear limits imposed by Congress in the ACA. Indeed, Grewal found the IRS "effectively provides the *largest* [subsidies] to persons who do *not* satisfy the statutory criteria."[39]

The IRS has gone rogue, taxing and spending the American people's money without permission from or accountability to Congress. The American people need to know how this happened. That begins with

transparency. I thank you for the opportunity to share my perspective, and I look forward to your questions.

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[2] U.S. Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, 77 Fed. Reg. 30,377 (May 23, 2012) (final rule).

[3] Scott Pruitt v. Sylvia Burwell, No. CIV-11-030-RAW (E.D. Okla. Sept. 30, 2014); and Jacqueline Halbig v. Sylvia Burwell, No. 14-5018 (D.C. Cir. Jul. 22, 2014). *But see* Order Granting En Banc Review, Halbig v. Burwell, No. 14-5018 (D.C. Cir. Sept. 4, 2014).

[4] Michael F. Cannon, King v. Burwell Would Free More Than 57 Million Americans From The ACA's Individual & Employer Mandates, DarwinsFool.com (Jul. 21, 2014).

[5] Sandhya Somashekhar, "Health-Care Law Is Tied To New Caps on Work Hours for Part-Timers," *Washington Post*, July 23, 2013.

[6] Douglas Holtz-Eakin and Brittany LaCouture, "TaKing Stock: The Potential Impact of *King v. Burwell*," American Action Forum, May 13, 2015, http://americanactionforum.org/research/taking-stock-the-potential-impact-of-king-v.-burwell.

[7] Douglas Holtz-Eakin and Brittany LaCouture, "TaKing Stock: The Potential Impact of *King v. Burwell*," American Action Forum, May 13, 2015, http://americanactionforum.org/research/taking-stock-the-potential-impact-of-king-v.-burwell.

[8] U.S. Constitution, Article I.

[9] Michael F. Cannon, King v. Burwell Would Free More Than 57 Million Americans From The ACA's Individual & Employer Mandates, DarwinsFool.com (Jul. 21, 2014).

[10] Douglas Holtz-Eakin and Brittany LaCouture, "TaKing Stock: The Potential Impact of *King v. Burwell*," American Action Forum, May 13, 2015, http://americanactionforum.org/research/taking-stock-the-potential-impact-of-king-v.-burwell.

[11] *See* 26 U.S.C. § 36B(b)(2)(A), (c)(2)(A)(i) (direct language); 26 U.S.C. § 36B(b)(3)(B), (b)(3)(B)(i), (b)(3)(C), (b)(3)(D), (b)(3)(E), (c)(2)(A)(ii), (e)(A) (cross-references).

[12] *See* I.R.C. §5000A(e)(1); I.R.C. §4980H.

[13] Brief for the Respondents, King v. Burwell, No. 14-114 (U.S. Jan. 21, 2015).

[14] Noah Feldman, "Justices Drop Another Clue About Obamacare's Future," Bloomberg View, April 22, 2015.

[15] See, for example, Jonathan H. Adler and Michael F. Cannon, Taxation Without Representation: The Illegal IRS Rule to Expand Tax Credits Under the PPACA, Health Matrix: Journal of Law-Medicine 23, No. 1 (2013): 119-195;

Jonathan H. Adler and Michael F. Cannon, The Halbig Cases: Desperately Seeking Ambiguity in Clear Statutory Text, Journal of Health Politics, Policy and Law (Nov. 25, 2014); and Brief of Amici Curiae Jonathan H. Adler and Michael F. Cannon, King v. Burwell, No. 14-114 (U.S. Dec. 29, 2014).

[16] Staff of H. Comm. on Oversight and Gov't Reform, 113th Cong., Administration Conducted Inadequate Review of Key Issues Prior to Expanding Health Law's Taxes and Subsidies (Comm. Print 2014).

[17] Thomas Edmondson, Opponents of New Federal Health Care Law Wage Constitutional War in Courts, Bloomberg BNA, (Jan. 4, 2011).

[18] Staff of H. Comm. on Oversight and Gov't Reform, 113th Cong., Administration Conducted Inadequate Review of Key Issues Prior to Expanding Health Law's Taxes and Subsidies (Comm. Print 2014).

[19] U.S. Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, Fed. Reg. 76 (August 17, 2011) (proposed rule).

[20] Staff of H. Comm. on Oversight and Gov't Reform, 113th Cong., Administration Conducted Inadequate Review of Key Issues Prior to Expanding Health Law's Taxes and Subsidies (Comm. Print 2014).

[21] Staff of H. Comm. on Oversight and Gov't Reform, 113th Cong., Administration Conducted Inadequate Review of Key Issues Prior to Expanding Health Law's Taxes and Subsidies (Comm. Print 2014).

[22] Lisa Rein, "Six words might decide the fate of Obamacare at the Supreme Court," *Washington Post*, March 1, 2015.

[23] See 26 U.S.C. § 36B(b)(2)(A), (c)(2)(A)(i) (direct language); 26 U.S.C. § 36B(b)(3)(B), (b)(3)(B)(i), (b)(3)(C), (b)(3)(D), (b)(3)(E), (c)(2)(A)(ii), (e)(A) (cross-references). *See also* Michael F. Cannon, George F. Will: 'Four Words in the ACA Could Spell Its Doom,'Forbes.com (Jan. 30, 2014).

[24] America's Affordable Health Choices Act of 2009, H.R. 3200, 11th Cong. (2009).

[25] Timothy S. Jost, "Health Insurance Exchanges: Legal Issues," O'Neill Institute Papers No. 23, April 27, 2009.

[26] Committee on Health, Education, Labor & Pensions, U.S. Senate, Affordable Health Choices Act, S. 1679, 111th Cong. (2009).

[27] Rep. Lloyd Doggett, et al., Letter to President Obama, January 11, 2010.

[28] David Hogberg, Oops! No Obamacare Tax Credit Via Federal Exchanges?, Investor's Business Daily (Sept. 7, 2011) ("'There is this technical problem in the law,' said James Blumstein, a professor at Vanderbilt Law School. 'I don't see how you get around that.'"); Jonathan H. Adler, The IRS Wants to Give Tax Credits for Health Insurance Purchases Beyond Those Provided for in the ACA, Volokh Conspiracy (Sep. 9, 2011); David Hogberg, Companies Could Challenge Obamacare Employer Fines, Investor's Business Daily (Sept. 16, 2011); Jonathan Adler and Michael Cannon, Another ObamaCare Glitch, Wall Street Journal Online (Nov. 16, 2011).

[29] *See* Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, Fed. Reg. 76 (August 17, 2011) (Comment of Brian Clark, Sept. 9, 2011); Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, Fed. Reg. 76 (August 17, 2011) (Comment of Nicole Kaeding, Oct. 5, 2011); Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, Fed. Reg. 76 (August 17, 2011) (Comment of David Ford, Oct. 18, 2011); Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, Fed. Reg. 76 (August 17, 2011) (Comment of Christopher Whitcomb, Aug. 22, 2012).

[30] *See* Rep. David Phil Roe, U.S. House of Representatives, Letter to Douglas Shulman, Comm'r, Internal Revenue Service (Nov. 4, 2011); Sen. Orrin G. Hatch, U.S. Senate, Letter to Timothy Geithner, Sec'y, Dep't of the Treasury and Douglas Shulman, Comm'r, Internal Revenue Serv. (Dec. 1, 2011); Sen. Jim Demint, *et al.*, "Letter to National Governors Association" (Jun. 29, 2012) ("[T]he IRS recently finalized a regulation that contradicts the law by allowing the federal government to provide premium assistance to citizens in those states that have not created exchanges. The IRS had no authority to finalize such a regulation. By refusing to create an exchange, you will assist us in Congress to repeal this violation which will help lower the costs of doing business in your state, relative to other states that keep these financially draining exchanges in place."); Rep. Darrell Issa, Chairman, Committee on

Oversight and Government Reform, U.S. House of Representatives, Letter to Douglas H. Shulman, Commissioner, Internal Revenue Service (Aug. 17, 2012); Committee on Oversight & Government Reform, U.S. House of Representatives, Letter to Treasury Secretary Geithner and IRS Commissioner Shulman (Oct. 18, 2012); Rep. Darrell Issa, Chairman, Committee on Oversight and Government Reform, U.S. House of Representatives, Letter to Douglas W. Elmendorf, Director, Congressional Budget Office (Nov. 30, 2012); Committee on Oversight & Government Reform, U.S. House of Representatives, Letter to Treasury Secretary Jacob Lew (July 25, 2013); Committee on Oversight & Government Reform, U.S. House of Representatives, Letter to Treasury Secretary Jacob Lew (Aug. 15, 2013).

[31] U.S. Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, 77 Fed. Reg. 30,377 (May 23, 2012) (final rule).

[32] Brief for the Respondents, King v. Burwell, No. 14-114 (U.S. Jan. 21, 2015).

[33] Lisa Rein, "Six words might decide the fate of Obamacare at the Supreme Court," *Washington Post*, March 1, 2015.

[34] Email correspondence between Catherine Arterton, Deputy Tax Legislative Counsel for Tax Policy, Department of the Treasury, to Jessica Hauser, Deputy Tax Legislative Counsel at the Department of Treasury, December 1, 2011.

[35] U.S. Department of the Treasury, Internal Revenue Service, Health Insurance Premium Tax Credit, Fed. Reg. 76 (August 17, 2011) (proposed rule).

[36] Lisa Rein, "Six words might decide the fate of Obamacare at the Supreme Court," *Washington Post*, March 1, 2015.

[37] Sen. Orrin G. Hatch, U.S. Senate, Letter to Timothy Geithner, Sec'y, Dep't of the Treasury and Douglas Shulman, Comm'r, Internal Revenue Serv. (Dec. 1, 2011).

[38] Rep. Darrell Issa, Chairman, Committee on Oversight and Government Reform, U.S. House of Representatives, Subpoena Letter to Treasury Secretary Jacob Lew (Sept. 23, 2014).

[39] Andy Grewal, "Lurking Challenges to the ACA Tax Credit Regulations," SSRN.com, April 23, 2015. Emphases added.