Full Steam Ahead: Affordable Care Act Preparations Continue for Employers and Issuers

On June 28, 2012, the Supreme Court of the United States issued its much-anticipated opinion in National Federation of Independent Business v. Sebelius, 567 U.S. __ (2012). The Court ruled on two key issues in the Patient Protection and Affordable Care Act (“ACA” or “Act”): (i) it upheld the constitutionality of the individual mandate as a tax; and (ii) it found unconstitutional a provision that would permit the Secretary of the Department of Health and Human Services (“HHS”) to withdraw all of the funding provided to a state if that state chooses not to expand Medicaid to certain thresholds set forth in the Act.

This memorandum provides a brief overview of the Court’s decision as well as a discussion of some of the near-term compliance issues confronting employers and issuers (per the accompanying chart entitled “Timeline for Near-Term ACA Compliance Activities”).

The Supreme Court’s Decision

The Supreme Court’s decision was surprising to many – not just because the Court upheld the constitutionality of the entire Act, but because of the approach it took in doing so.

At issue was the constitutionality of two provisions of the Act – the requirement that most Americans obtain certain qualifying coverage or pay a “tax penalty,” which is commonly referred to as the “individual mandate” (“Individual Mandate”), and the grant of permission to the HHS Secretary to withdraw all of the funding provided to a specific state if that state chooses not to expand Medicaid to certain additional individuals as required by the Act (“Medicaid Provision”).

Regarding the Individual Mandate

The Individual Mandate is codified in new section 5000A of the Internal Revenue Code of 1986, as amended (“Code”), which was added by section 1501 of the ACA. Code section 5000A states that “[a]n applicable individual shall for each month beginning after 2013 ensure that the individual, and any dependent of the individual who is an applicable individual, is covered under minimum essential coverage for such month.”

As played out before numerous Federal Circuit Courts, multiple stakeholders, including Attorneys General on behalf of more than half of the states, argued that the Individual Mandate was unconstitutional.

Following several days of oral arguments in March of this year, the Court issued its opinion on June 28, 2012, upholding the constitutionality of the Individual Mandate. Although the Court struck down the Individual Mandate as an improper use of Congress’s authority under the Commerce Clause (which generally provides Congress broad authority to regulate interstate commerce and activities affecting interstate commerce), it upheld the Individual Mandate as a valid use of Congress’s taxing power. In a 5-4 decision, the Court upheld the Individual
Mandate based on Congress’s broad authority under the Constitution to “lay and collect taxes.” Art. I, § 8, cl. 1. Writing for the majority, Chief Justice Roberts stated that the Individual Mandate was effectively a tax and, as such, rendered the law constitutional. Specifically, the Court stated:

The Affordable Care Act’s requirement that certain individuals pay a financial penalty for not obtaining health insurance may reasonably be characterized as a tax. Because the Constitution permits such a tax, it is not our role to forbid it, or to pass upon its wisdom or fairness.

Slip Op. at 44.

Regarding the Medicaid Provision

Under current Medicaid rules, states are required to only cover certain categories of individuals, such as pregnant women, children, needy families, the blind, the elderly, and the disabled. States typically do not offer coverage to childless adults, and they have flexibility as to the level of coverage they provide to covered categories of individuals.

Pursuant to the Medicaid Provision, which appears in section 2001 of the ACA, Medicaid coverage would be expanded to nearly all individuals under age 65 with incomes up to 133% of the federal poverty line. The federal government would provide a significant subsidy to states for providing such expanded Medicaid coverage. However, pursuant to ACA section 2001, if a state did not expand Medicaid accordingly, then the HHS Secretary would have the authority to withdraw all federal Medicaid funding received by that state.

The Court concluded that the Medicaid Provision exceeds Congress’s authority under the spending power, and thus is unconstitutional, because it would permit the HHS Secretary to withdraw all federal Medicaid funding received by the states. The Court reasoned that the expansion of the Medicaid program contemplated by the Medicaid provision is not just a modification of the Medicaid program; a state could not have anticipated that the Medicaid program would have been modified to such an extent. The Court stated that the constitutional violation is fully remedied by precluding the HHS Secretary from withdrawing existing Medicaid funds for failure to comply with the requirements set out in the Medicaid Provision.

Implications of the Court’s Decision

The Court’s holding raises some interesting issues for employers, administrative service organizations (“ASOs”), and issuers alike. Specifically, in holding that the Individual Mandate constitutes a valid tax, the Court focused on the fact that the Individual Mandate was not punitive in nature. This was important to the Court’s holding, because, generally for a tax to be valid, it

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1 Significantly, although the Court concluded that the Individual Mandate is a tax for purposes of determining its constitutionality under the taxing power, it concluded that the Individual Mandate is not a tax for purposes of the federal Anti-Injunction Act, which generally bars suit to challenge the collection of a tax before the tax is actually collected. With respect to the Individual Mandate, no amounts will be collected by the government until 2014.
cannot be punitive in nature. The Court indicated that the provision did not even approach being punitive in nature, stating:

We have already explained that the shared responsibility payment’s practical characteristics pass muster as a tax under our narrowest interpretations of the taxing power. Because the tax at hand is within even those strict limits, we need not here decide the precise point at which an exaction becomes so punitive that the taxing power does not authorize it.

Slip Op. at 43 (internal citations omitted).

Many stakeholders as well as commentators have questioned whether the existing “tax penalty” is of a sufficient amount to cause healthy, uninsured individuals (“Young Invincibles”) to enter the insurance markets. The general concerns are that if the tax penalty is insufficient, (i) the insurance markets will not benefit from an influx of better than average health risks, and (ii) Young Invincibles will wait to secure insured coverage until they need it, e.g., after they become injured or ill.

It is our understanding that certain stakeholders have argued that the tax penalty should be increased to protect the insurance markets against the deleterious effects of adverse selection. Based on the majority’s opinion, however, query the extent to which increasing the amount of the existing tax penalty could subject the Individual Mandate to a new constitutional challenge to the extent the modifications render it punitive in nature.

Another interesting outgrowth of the Court’s decision is the extent to which it reaffirms that an individual has a free economic choice as to how he or she complies with the Individual Mandate. Essentially an individual may choose to either (i) forego coverage today and pay the resulting tax penalty (albeit with the ability to secure guaranteed coverage when needed), or (ii) secure qualifying coverage at the outset and avoid the tax penalty in its entirety. Per the Court’s decision, regardless of an individual’s choice, he or she is a good, law-abiding citizen. In this regard, the Court states as follows:

While the individual mandate clearly aims to induce the purchase of health insurance, it need not be read to declare that failing to do so is unlawful. Neither the Act nor any other law attaches negative legal consequences to not buying health insurance, beyond requiring a payment to the IRS.

Slip Op. at 37.

In light of the foregoing, one could expect Young Invincibles and others to engage in an economic analysis that could lead some to forego coverage in favor of paying the tax penalty unless and until the time when they otherwise need coverage – at which point they would enroll
in coverage that is guaranteed to be available to them in the individual insurance markets.

Lastly, as noted above, the Court also ruled unconstitutional the Medicaid Provision, which would have permitted the HHS Secretary to withdraw all of the funding provided to a state if that state chooses not to expand Medicaid to certain thresholds set forth in the Act. The Court’s ruling with respect to the Medicaid Provision could pose some interesting issues for individuals as well as for employers with lower wage workers who might otherwise be eligible for coverage under a state’s Medicaid program.

One question that has arisen is whether individuals who reside in a state that elects not to expand Medicaid coverage to individuals with household income up to 133% of the federal poverty line will be exempted from the Individual Mandate. Very generally, the Individual Mandate is imposed on all individuals other than certain individuals exempted for religious reasons, individuals who are not lawfully present in the US, and incarcerated individuals. Additional exemptions apply in connection with financial status: (i) if an individual’s required contribution for coverage for a month exceeds 8% of household income; or (ii) if an individual has income below the income tax return filing threshold (generally income less than the sum of the personal exemption and the standard deduction). With respect to the former, most individuals with household income between 100% and 133% of the federal poverty line would seem to be eligible to receive a premium tax credit (and thus their required contributions may not be in excess of 8% of household income). Accordingly, those individuals very possibly would not be exempted and hence would be subject to the Individual Mandate and applicable penalty.

Another question that has arisen in light of the Court’s holding pertains to the Act’s employer shared responsibility provisions, or what is more commonly referred to as the “employer mandate” or “pay or play.” Pursuant to new Code section 4980H, as added by section 1513 of the Act, for months beginning on or after January 1, 2014, certain large employers will have to provide affordable coverage that provides minimum value to employees or face a penalty. If an employee obtains a premium tax credit and purchases insurance through an Exchange, then the employer could be liable for a penalty.

Pursuant to new Code section 36B, premium tax credits generally will be available to taxpayers with household income of or between 100% and 400% of the federal poverty level who do not receive Medicaid coverage, among others. Thus, if states choose not to expand Medicaid coverage to taxpayers with household income up to 133% of the federal poverty limit, it is possible that some additional individuals who would otherwise have become covered by Medicaid as a result of the expansion could receive a premium tax credit and cause an employer to become liable for a penalty under Code section 4980H.

**Ongoing Compliance Activities and Near-Term Requirements**

Notwithstanding the political and historical significance of the Court’s decision, the ruling is unlikely to materially affect the ongoing compliance activities of employers, ASOs and issuers. The upcoming presidential and congressional elections on November 6th could certainly lead to changes to, or possibly a wholesale repeal of, the ACA, depending in large part on whether President Obama is reelected and/or whether Republicans take control of the Senate and
maintain control of the House. Nonetheless, employers, issuers, and ASOs likely would be best served by continuing to work toward complying with the various provisions of the ACA, especially given that many new requirements take effect this summer or fall, or with respect to 2013 plan year coverage.

For your convenience, the accompanying chart sets forth a series of near-term issues that should be considered by employers, ASOs and issuers as part of their ongoing ACA compliance efforts.

For more information, please call (202) 624-2500.

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