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Circuit Court Split on ACA Could Impact Employer Penalties

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In conflicting opinions released on July 22nd, two federal circuits split on whether Affordable Care Act subsidies are available under a federally operated health insurance exchange. "Pay or play" penalties apply only if employees obtain subsidized coverage from an exchange, and the majority of exchanges are wholly or partly operated by the federal government. Therefore, the resolution of this split will be significant for most large employers.

Why Were These Cases Brought?

The Affordable Care Act (ACA) gave states the primary responsibility for establishing exchanges. The deadline for doing so was January 1, 2014. If a state failed to establish an exchange by the deadline, the ACA provided for the U.S. Department of Health and Human Services (HHS) to operate the exchange for or with the state.

Currently, only 14 states and the District of Columbia wholly operate their exchanges. HHS maintains or facilitates the operation of the exchanges in the remaining 36 states, which include approximately 2/3 of the nation's population.

Subsidies for health insurance purchased on an exchange are available to individuals with a household income of up to four times the federal poverty level ($45,960 for a one-person household, $94,200 for a family of four). The ACA calculates the subsidy available in a state by reference to the premium charged for health insurance purchased on the "Exchange established by the State." The meaning of this phrase was the subject of the lawsuits.

The IRS makes subsidies available for insurance purchased on any exchange, regardless of whether the exchange is operated by a state or the federal government, and has issued regulations reflecting this position. The plaintiffs in these cases challenged the IRS regulations on the grounds that they conflict with the language in the ACA that appears to limit subsidies to insurance purchased a state-operated exchange.

What Is at Stake for Employers?

Employers subject to the “pay or play” rules care about these decisions because the availability of subsidies helps determine whether they could become subject to a penalty for failing to offer health insurance to their employees. Two penalties may apply:

- The “subsection (a) penalty” (for failing to offer substantially all full-time employees an opportunity to enroll for coverage) is triggered only if a full-time employee obtains coverage from an exchange and qualifies for a subsidy.
- The “subsection (b) penalty” (for offering coverage that is unaffordable or less than minimum value) is triggered for each employee who obtains coverage from an exchange and qualifies for a subsidy.

Therefore, if an employer operates only in states where no subsidies are available, the employer could effectively be exempt from both “pay or play” penalties.

The Decisions

The conflicting circuit court opinions are *King v. Burwell* (4th Circuit) and *Halbig v. Burwell* (D.C. Circuit). The 4th Circuit decided unanimously in favor of the government, upholding the availability of subsidies in all states. The D.C. Circuit decided in favor of the challengers, with one judge dissenting. The decisions are summarized below.

	4th Circuit	D.C. Circuit	Dissent
Statutory language	The subsidy provision is ambiguous in the context of the full ACA.	The ACA unambiguously restricts subsidies to insurance purchased on exchanges established by the State.	The subsidy provision is ambiguous, but the better reading is that subsidies are not limited to state-operated exchanges.
—Plain language	The subsidy provision could be read to mean that HHS acts on behalf of the state when it establishes an exchange.	The subsidy provision plainly limits subsidies to exchanges operated by the state.	The subsidy provision could be read to mean that HHS acts on behalf of the state when it establishes an exchange.
—Context	Limiting subsidies to state-operated exchanges could conflict with other provisions of the ACA.	Limiting the subsidy to state-operated exchanges does not conflict with other provisions of the ACA.	Limiting the subsidy to state-operated exchanges would render other provisions of the ACA superfluous.
—Legislative history	The legislative record reflects an assumption that every state would establish its own exchange, but does not address this issue.	Congressional intent on this issue is not reflected in the legislative record.	The legislative record provides no support for the majority position that Congress wanted to use subsidies to incentivize states to create their own exchanges.

—Policy	Offering subsidies under state- and federally operated exchanges advances the policy goals of the ACA.	The fact that limiting the subsidy to state-operated exchanges could thwart the ACA's policy goals does not mean that the provision should be rewritten by the court.	The subsidy is a necessary element of the ACA. If Congress meant to deny subsidies in states with federally operated exchanges, it would have done so explicitly.
IRS rule	The IRS regulations are entitled to deference because the statute is ambiguous. The IRS regulations are a permissible construction of the statute.	The subsidy provision unambiguously forecloses the interpretation embodied in the IRS regulations.	The IRS regulations are entitled to deference because the statute is ambiguous. The IRS construction of the statute is consistent with the ACA's text, structure and purpose.
Disposition	IRS regulations upheld.	IRS regulations vacated.	

An automatic stay is currently in effect with respect to the D.C. Circuit decision. On August 1, the Department of Justice filed a petition for the D.C. Circuit to rehear the case en banc. On July 31, the challengers in the 4th Circuit case filed a petition for review with the Supreme Court.

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