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## Obamacare and the 'What Is a Tax?' Question — Part II

by Steve R. Johnson



We are engaged in a two-part exploration. The previous installment of our column reviewed the perennial question of whether a given state or local exaction should be classified as a tax or something else. It rehearsed the contexts in which the issue has arisen in state and local tax controversies, the practical stakes involved

in those controversies, and the criteria courts have developed to distinguish between taxes and other types of governmental levies.<sup>1</sup>

The previous installment also said that a new source of guidance as to the "what constitutes a tax?" question is developing: litigation over the individual mandate and shared responsibility payment (SRP) portions of the Patient Protection and Affordable Care Act of 2010 (PPACA), so-called Obamacare.<sup>2</sup> The current installment of our column details how the PPACA litigation sheds light on what constitutes a tax.

The first part of this installment lays the foundation by developing how the tax classification issue arises under challenges to the PPACA. The second part sketches prominent arguments that have been advanced in the PPACA litigation to date regarding whether the SRP constitutes a tax. The third part describes the principal effects that the PPACA arguments may have on future state and local litigation on the "what is a tax?" question.

<sup>1</sup>Steve R. Johnson, "Obamacare and the 'What Is a Tax?' Issue - Part I," *State Tax Notes*, Jan. 9, 2012, p. 155, *Doc 2011-24888*, or *2012 STT 5-2*.

<sup>2</sup>P.L. No. 111-148, 124 Stat. 119 (2010).

### Classification Issue in PPACA Litigation

With some exceptions, the PPACA's individual mandate provision requires all individuals to obtain "minimum essential [medical insurance] coverage" for each month.<sup>3</sup> Those failing to do so must include the SRP as part of their federal income tax payment for the year.<sup>4</sup>

The individual mandate and the SRP are highly controversial, both politically and legally. Dozens of cases have been brought challenging the validity of the provisions. Many of those suits have been dismissed on procedural grounds, such as lack of standing or ripeness. The cases that have reached decision on the merits have produced a welter of majority, concurring, and dissenting opinions, with the judges seriously split on the merits. The U.S. Supreme Court has granted review, with oral argument to be heard on March 26, 2012.<sup>5</sup>

Of the numerous arguments considered in the PPACA cases, two are of principal significance to our topic: (1) that the Anti-Injunction Act (the AIA)<sup>6</sup> and the Declaratory Judgment Act (the DJA)<sup>7</sup> bar pre-enforcement review of constitutional challenges to the PPACA provisions and (2) that enactment of the PPACA was within the authority of Congress under the taxing and spending clause of the U.S. Constitution.<sup>8</sup>

With exceptions not relevant here, the AIA provides that "no suit for the purpose of restraining the

<sup>3</sup>PPACA section 1501, codified at section 5000A.

<sup>4</sup>Section 5000A(b).

<sup>5</sup>*State of Florida v. Dept. of Health & Human Serv.*, 648 F.3d 1235 (11th Cir. 2011), *cert. granted*, 132 S. Ct. 603 and 604 (Nov. 14, 2011). For the decision, see *Doc 2011-17561* or *2011 STT 158-2*.

<sup>6</sup>Section 7421.

<sup>7</sup>28 U.S.C. section 2201.

<sup>8</sup>U.S. Const. Art. I, section 8, cl. 1.

assessment or collection of any tax shall be maintained in any court by any person.<sup>9</sup> Is the SRP a tax for AIA purposes? If the Supreme Court holds that it is, review of the constitutional challenges could not precede assessment of SRPs after filing of returns. Realistically, that could delay review on the merits until 2020 or later.<sup>10</sup>

**If the Supreme Court holds that the SRP is a tax, review of the constitutional challenges could not precede assessment of SRPs after filing of returns. That could delay review on the merits until 2020.**

Originally, the federal government was, and even under current jurisprudence it may still be, a creature of limited authority. The taxing and spending clause has been suggested as one candidate for an enumerated power by which Congress had authority to enact the PPACA. If the SRP constitutes a tax for taxing and spending purposes, the individual mandate should be upheld in litigation, whether (depending on the AIA) constitutional review occurs before or after attempts to enforce the SRP. The AIA issue and the taxing and spending issue are independent. It is settled that a measure's classification as a tax or nontax for constitutional purposes does not control for statutory purposes and vice versa.<sup>11</sup>

Only one court has held that the AIA bars pre-enforcement review of the individual mandate and SRP provisions.<sup>12</sup> However, a number of other judges (in dissent),<sup>13</sup> amici (in briefs),<sup>14</sup> and com-

mentators<sup>15</sup> take the same view. Most courts take a contrary position.<sup>16</sup> The issue has sufficient substance that the solicitor general recommended that the Supreme Court appoint an amicus to argue the position that the AIA bars pre-enforcement review.

At the constitutional level, the main attention of courts and commentators has been on whether the Constitution's commerce clause granted Congress authority to enact the individual mandate. Thus, the taxing and spending issue has received less attention than the AIA issue. Thus far, the view of the courts has been that the SRP does not constitute a tax covered by the taxing and spending clause.<sup>17</sup>

#### Principal Arguments to Date

The judicial opinions, briefs, and commentary noted above explore numerous precedential and analytical points as to the tax versus nontax issue. The points tend to overlap for both AIA and taxing and spending purposes. The matters bearing most directly on classification for state and local tax purposes are described below. Other matters, of lesser pertinence to us, also appear in the PPACA context but are omitted from the following discussion.

The pertinent points cluster into five categories:

- statutory text;
- structure of the statute;
- history of the legislation;
- legislative purpose; and
- deference.

The points are addressed in many of the authorities cited in footnotes 11 through 17 in Part I.

#### Text

The language of section 5000A describes the SRP as a "penalty," not as a tax. From this, many courts and commentators advance a "plain language of the

<sup>9</sup>Section 7421(a). In cases in which the AIA prohibits injunctive relief, the DJA prohibits declaratory relief. Most courts hold the two statutes to be coextensive. See, e.g., *Cohen v. United States*, 650 F.3d 717, 727-31 (D.C. Cir. 2011) (*en banc*).

<sup>10</sup>See Steve R. Johnson, "The Anti-Injunction Act and the Individual Mandate," *Tax Notes*, Dec. 12, 2011, p. 1395, at 1401.

<sup>11</sup>For example, the Supreme Court held that an exaction under a child labor statute was a tax under the predecessor of the AIA. *Bailey v. George*, 259 U.S. 16 (1922). In a companion case, however, the Court held that the same measure was not a tax for constitutional purposes. *Bailey v. Drexel Furniture Co.*, 259 U.S. 20 (1922).

<sup>12</sup>*Liberty Univ. v. Geithner*, \_\_\_ F.3d \_\_\_, 2011 WL 396215 (4th Cir. 2011) (*Liberty Univ. I*), vacating & remanding 753 F. Supp. 2d 611 (W.D. Va. 2010) (*Liberty Univ. II*).

<sup>13</sup>The lengthiest and most nearly persuasive explication of the view that the AIA bars pre-enforcement review is Judge Brett Kavanaugh's dissent in *Seven-Sky v. Holder*, 661 F.3d 1, 21 (D.C. Cir. 2011).

<sup>14</sup>Brief for Amici Curiae Tax Law Professors Supporting Vacatur (Anti-Injunction Act), *HHS v. State of Florida*, No. 11-398 (Sup. Ct. Jan. 13, 2012); Corrected Brief of Amici Curiae Mortimer Caplin and Sheldon Cohen in Support of

(Footnote continued in next column.)

Appellees & Affirmance, *Seven-Sky*, *supra* note 13, 2011 WL 2847595 (D.C. Cir. 2011). Caplin and Cohen are former IRS commissioners.

<sup>15</sup>E.g., Kevin C. Walsh, "The Anti-Injunction Act, Congressional Inactivity, and Pre-Enforcement Challenges to Section 5000A of the Tax Code," \_\_\_ *U. Richmond L. Rev.* \_\_\_ (forthcoming 2012). But see Michael C. Dorf and Neil S. Siegel, "Early-Bird Special' Indeed!: Why the Tax Anti-Injunction Act Permits the Present Challenges to the Minimum Coverage Provision," 121 *Yale L.J. Online* 389 (2012).

<sup>16</sup>E.g., *Thomas More Law Center v. Obama*, 651 F.3d 529 (6th Cir. 2011) (*Thomas More II*), *affg* 720 F. Supp. 2d 882 (E.D. Mich. 2010) (*Thomas More I*); *U.S. Citizens Ass'n v. Sibelius*, 754 F. Supp. 2d 903 (N.D. Ohio 2011); *Virginia v. Sebelius*, 729 F. Supp. 2d 768 (E.D. Va. 2010) (*Virginia I*), *rev'd on other grounds*, 658 F.3d 253 (4th Cir. 2011) (*Virginia II*).

<sup>17</sup>E.g., *State of Florida v. HHS*, 648 F.3d 1235 (11th Cir. 2011) (*State of Florida II*), *affg in part & rev'g in part* 716 F. Supp. 2d 1120 (N.D. Fla. 2010) (*State of Florida I*); *Thomas More II*, *supra* note 16, 651 F.3d at 550-554 (Sutton, J., concurring for majority of the court).

statute" argument.<sup>18</sup> That derives additional force, in those authorities' eyes, from the fact that in other contexts (such as PPACA sections 1405, 9001, and 9015), the PPACA uses the word "tax," suggesting that the legislature knew to say "tax" when it meant "tax."

Further, the PPACA is accompanied by legislative findings. Those findings assert that the commerce clause, not the taxing and spending clause, is the constitutional basis for enactment of the PPACA.<sup>19</sup>

### Structure

Congress chose to lodge the SRP in the code. An aggressive reading is that anything in a federal (or state) tax statute is a tax. Many courts have rejected that reading, however, noting that the tax code contains many provisions that are not taxes.<sup>20</sup>

Both sides in the AIA debate offer arguments based on the code parts in which the SRP is lodged and to which cross-references are made.<sup>21</sup> Placement arguments may be undercut by the principle (sometimes honored, sometimes flouted) that location within a statute is not controlling.<sup>22</sup>

The PPACA declares that the SRP generally "shall be assessed and collected in the same manner as an assessable penalty under subchapter B of Chapter 68" of the code.<sup>23</sup> A provision within chapter 68 states that penalties are "assessed and collected in the same manner as taxes," and assessable penalties are within the definition of tax for purposes of IRS assessment authority.<sup>24</sup> However, the PPACA denied the IRS tools by which taxes are typically enforced and their nonpayment is punished — tools such as tax liens, levies, and criminal prosecution.<sup>25</sup>

### History

The description of the SRP changed. Early versions of what would become the PPACA called the

SRP a tax, but the enacted version calls it a penalty. Committee and staff reports have been enlisted on both sides of the clash, but it cannot fairly be said that, taken as a whole, they are decisive.<sup>26</sup> That the SRP provision originated in the Senate, not in the House as is constitutionally mandated for taxes, has been noted by some courts but is not a major component of the analysis.

### Purpose

A point of central significance to judges who view the SRP as not a tax for either statutory or constitutional purposes is the perception that the goal of the SRP is to influence behavior, not to raise revenue. Litigation regarding the validity of the individual mandate and the SRP need not interfere with the operations of the IRS, especially given that the SRP would not be collected before 2015.

### Deference

The Department of Justice originally maintained that the AIA bars pre-enforcement review of the individual mandate and the SRP, but it has since recanted that view.<sup>27</sup> Some reason that the position of the government should receive deference, particularly because the AIA and DJA were enacted for the government's benefit.

### Effect on State-Local Litigation

Some of the "what is a tax?" analysis in the PPACA litigation proceeds along lines familiar to those who litigate this issue in state and local tax cases. For instance, some of the authorities frequently cited in the state-local context also appear often in the opinions in PPACA cases.<sup>28</sup>

However, the biggest effect of the PPACA cases on state-local litigation may be their potential to modify two familiar principles. Those principles are the relative unimportance of the labels attached to particular enactments and the use of impact analysis in distinguishing between taxes and penalties.

### Labels

It had often been held in pre-PPACA "what is a tax?" case law that classification turns on the levy's

<sup>18</sup>For discussion of this principle of statutory interpretation, see Steve R. Johnson, "Use and Abuse of the Plain Meaning Doctrine," *State Tax Notes*, Sept. 22, 2008, p. 831, *Doc 2008-19121*, or *2008 STT 185-3*.

<sup>19</sup>See 42 U.S.C. section 18091(a)(1) and (2).

<sup>20</sup>*E.g.*, section 527(j) (penalty for failure to make required disclosure as to election); section 5761(c) (penalty for domestic sale of tobacco labeled for export) and section 9707 (penalty on mining operators failing to pay retirement medical benefit premiums).

<sup>21</sup>The SRP was lodged under the Miscellaneous Excise Taxes heading of the code. These arguments become elaborate. Their most recent explications appear in the majority and dissenting opinions in *Seven-Sky*, *supra* note 13.

<sup>22</sup>No inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or group of any particular section or portion of this title." Section 7806(b).

<sup>23</sup>Section 5000A(g)(1).

<sup>24</sup>Sections 6671(a) and 6201(a).

<sup>25</sup>Section 5000A(g)(2).

<sup>26</sup>*See, e.g.*, Joint Comm. on Taxation, "Estimated Revenue Effects of the Manager's Amendment to the Revenue Provisions Contained in the Patient Protection and Affordable Care Act," as Passed by the Senate on December 24, 2009," at 2 (JCX-10-10 Mar. 11, 2010).

<sup>27</sup>*E.g.*, Supplemental Brief of Appellees, *Liberty Univ. II*, *supra* note 12, 2011 WL 2135095 at \*2 (4th Cir. May 31, 2011); *see also Goudy-Bachman v. HHS*, 764 F. Supp. 2d 684 (M.D. Pa. 2011), *further opinion*, \_\_\_ F. Supp. 2d \_\_\_, 2011 WL 4072875 (M.D. Pa. 2011).

<sup>28</sup>Such as *United States v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213 (1996), and *United States v. LaFranca*, 282 U.S. 568 (1931). The appearance of these decisions in state and local tax cases is noted by Johnson, *supra* note 1, at 158, note 30.



“practical operation, not its definition or the precise form of descriptive words which may be applied to it.”<sup>29</sup> Many opinions in PPACA cases also invoke that principle.<sup>30</sup>

However, many other PPACA opinions are contrary to the principle or at least in tension with it. The most commonly invoked argument against classifying the SRP as a tax is that the statute calls it a penalty rather than a tax.<sup>31</sup> For the many judges invoking that argument, the label attached to the measure matters very much indeed.

There are two related, interesting strands of this argument. First, for some courts, label is independently significant. For others, it is more important as an indicator — perhaps the best indicator — of legislative intent. Some judges would make legislative intent controlling or nearly so.<sup>32</sup>

Second, one reason for the vigor with which this consideration is pressed is the notion of political accountability. Before the PPACA was enacted, the president and his congressional allies repeatedly stated, with the transparent objective of minimizing opposition, that the SRP is not a tax. Since that argument was made for political reasons, some see it as unseemly that the validity of the measure should now be defended on the ground that it is a tax after all. Allowing that classificatory “bait and switch” undermines the accountability of our elected representatives.<sup>33</sup>

Could a similar tack be taken in a future state or local tax case? You bet. Subnational chief executives and legislators are not free of the temptations confronted (not always successfully) by the president and members of Congress. States and localities sometimes enact revenue measures that really are taxes but are called something else in order to defang political opposition.<sup>34</sup> A judge who has had

her fill of that behavior may let that annoyance show in a classificatory decision.

### Impact Analysis

The standard distinction made between a tax and a penalty refers to their effects. A tax burdens persons or property in order to support government, while a penalty regulates conduct and punishes for a proscribed act or omission.<sup>35</sup> Many of the PPACA cases also looked at that distinction.

**The PPACA cases make it clear that the traditional distinction regarding effects is a matter of degree, not of kind, and the degree of difference may be difficult to detect and apply in actual cases.**

However, the seeming support the PPACA cases give to the distinction is undercut on closer examination. Decisions have said that “every tax is in some measure regulatory” by imposing “an economic impediment to the activity taxed,”<sup>36</sup> and that every penalty is revenue raising in some measure unless it is never imposed. In short, the PPACA cases make it clear that the traditional distinction regarding effects is a matter of degree, not of kind, and the degree of difference may be difficult to detect and apply in actual cases.

### Conclusion

State courts are routinely called on to determine whether particular levies constitute taxes or something else. In their search for precedents and analysis, those tribunals often consider federal cases. The current litigation about whether the SRP in the PPACA constitutes a tax has developed numerous perspectives, some of which may prove to be influential in future state litigation. It will be interesting to watch the next act of the drama, the Supreme Court’s analysis of the question in the *State of Florida* case now awaiting oral argument. ☆

<sup>29</sup>*Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 363 (1941) (punctuation and citations omitted); see also *Reorganized CF & I*, *supra*, 518 U.S. at 220; *Helwig v. United States*, 188 U.S. 605, 613 (1903).

<sup>30</sup>*E.g.*, *Liberty Univ. II*, *supra*, 2011 WL 3962915, at \*7; *State of Florida II*, *supra*, 648 F.3d at 1317-18.

<sup>31</sup>*E.g.*, *Thomas More II*, *supra* note 16, 651 F. 3d at 551; *State of Florida II*, *supra* note 17, 648 F.3d at 1614-16; *Virginia I*, *supra* 16, 728 F. Supp. 2d at 786-87.

<sup>32</sup>See, *e.g.*, *Seven-Sky*, *supra* note 13, 661 F.3d at 6-7 (suggesting that “tax” means “anything collected as a tax . . . so long as it was claimed by the proper public officers to be a tax”) (internal punctuation omitted) (quoting *Snyder v. Marks*, 109 U.S. 189, 192 (1883)); *Liberty Univ. II*, *supra*, 2011 WL 3962915, at 25 (Davis, J., dissenting). See generally Steve R. Johnson, “The Two Kinds of Legislative Intent,” *State Tax Notes*, Mar. 30, 2009, p. 1045, Doc 2009-5906, or 2009 STT 59-3.

<sup>33</sup>See *State of Florida I*, 716 F. Supp. 2d at 1142-43.

<sup>34</sup>See Johnson, *supra* note 1, at 158.

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

<sup>36</sup>*Sonzinsky v. United States*, 300 U.S. 506, 513 (1983); see also *Bob Jones Univ. v. Simon*, 416 U.S. 725, 741 (1974); *United States v. Sanchez*, 340 U.S. 42, 44-45 (1951). These cases are discussed by *Virginia I*, *supra* note 16, 728 F. Supp. 2d at 782-86, and other PPACA opinions.