

PUBLICATION

Supreme Court Upholds Individual Mandate as a Tax

July 10, 2012

In a much anticipated ruling with far-reaching repercussions, a sharply divided Supreme Court on June 28 upheld the Individual Mandate provisions of the Patient Protection and Affordable Care Act (ACA) and its shared responsibility payment, but struck down the Medicaid Mandate which would have required states to expand Medicaid coverage in order to retain existing Medicaid funding. The rationale for upholding the Individual Mandate (a most controversial provision within the ACA requiring Americans to carry health insurance or make a shared responsibility payment to the IRS) was not the Commerce Clause, as had been argued by the proponents of ACA. Rather, the rationale for upholding the Mandate was the Taxing Clause, upon which the drafters of ACA and President Obama repeatedly disclaimed reliance when the ACA was being considered by Congress.

The Anti-Injunction Act Does Not Prevent a Decision

An initial question addressed by the Court on its own motion, which had not been raised by the defenders of ACA, was the Anti-Injunction Act. The Court raised this issue on its own to be certain that it even had the authority to consider the constitutionality of the Individual Mandate.

The Anti-Injunction Act was enacted long before passage of the present Internal Revenue Code. That Act provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." The usual rule (subject to enumerated exceptions such as the ability of taxpayers to petition the United States Tax Court for a redetermination of a tax deficiency) is that taxes can ordinarily be challenged only after they are paid.

The Court, in what many consider to be strained logic, reassured that the financial exaction imposed by the Individual Mandate was not a tax but a penalty for the purpose of applying the Anti-Injunction Act. This reasoning was further supported by the majority's acknowledgement that because the Anti-Injunction Act was a legislative creation, the terminology used to construct the shared responsibility payment, for purposes of the Anti-Injunction Act, is controlling. As a result, the Court concluded that it did have the authority to consider the constitutionality of the Individual Mandate.

The Commerce Clause Does Not Save the Individual Mandate

The Government's principal argument in favor of the Individual Mandate's constitutionality was that Congress is authorized by the Commerce Clause to enact such legislation. Chief Justice John Robert's majority opinion, although not joined by the other justices in the majority on this matter, acknowledges Congress's broad authority over activities affecting interstate commerce; but he ultimately disagreed with the Government's position. The opinion states that "[C]ongress has never attempted to rely on [the Commerce Clause] to compel individuals not engaged in commerce to purchase an unwanted product." And while the Chief Justice was quick to state that such action's novelty was not its downfall, he cautioned by adding that the lack of historical precedent is a "telling indication of [a] severe constitutional problem."

Justices Roberts, Kennedy, Alito, Scalia and Thomas each concluded that Congress's vested authority under the Commerce Clause does not permit the regulation of private individuals' failure to act, or in this case their election to not purchase health insurance. Chief Justice Roberts notes: "The language of the Constitution reflects the natural understanding that the power to regulate assumes there is already something to be regulated."

Therefore the government's argument in favor of upholding the Individual Mandate on account of Congress's broad authority under the Commerce Clause was not persuasive to a majority of the Justices. This conclusion is a very important, although possibly unsatisfying, victory for those individuals concerned over whether the Commerce Clause permits Congress to require all private citizens to purchase an unwanted private product.

Mandate Upheld Under General Taxing Authority

In a surprising twist, Chief Justice Roberts joined the Supreme Court's four liberal justices in upholding the Individual Mandate as constitutional under Congress's taxing power, i.e., its power to levy and collect taxes. In doing so, the Court determined that the label of a "penalty" given to the shared responsibility payment was not controlling in determining whether an exaction is within Congress's constitutional power to tax. The Court found that the shared responsibility payment required under the Internal Revenue Code has many of the common characteristics of a tax.

The Court relied on legal precedent established in prior cases involving child labor, licenses to sell liquor and lottery tickets and surcharges on out-of-state nuclear waste shipments in determining that the constitutional question of whether a particular payment is a tax was not controlled by Congress's choice of the label. The prior cases employed an analysis that viewed the substance, application and practical operation of the payment, not its definition or the precise form of descriptive words, in determining whether a payment constituted a tax.

The Court stated that the concept of a penalty generally means "punishment for an unlawful act or omission," and found that the ACA does not make failure to buy medical insurance an unlawful act and does not attach negative consequences to such failure. The ACA requires a payment to the IRS, and after doing so the taxpayer is in compliance with the law. In the final analysis, the Court determined that Congress has the power to impose the payment under its taxing power, and that alone is sufficient to sustain it.

The Court noted that Congress has clearly used its taxing power to influence conduct, although not without limits, and the shared responsibility payment of the Individual Mandate passes muster as a tax under the narrowest interpretation of Congress's taxing power.

Strong Dissent to Taxing Clause Applicability

Justices Scalia, Kennedy, Thomas and Alito wrote a strong dissent to the majority's opinion and determined that since the majority found that Congress exceeded its power under the Commerce Clause, that was enough to find the shared responsibility payment invalid given that Congress chose not to enact the legislation as a tax. The dissent pointed out that 18 times in the provision of the Internal Revenue Code imposing the shared responsibility payment itself and elsewhere through the ACA, Congress referred to the exaction as a "penalty," and the Individual Mandate was contained in Title I of the Act (Operative Section,) not Title IX, which contains the revenue provisions.

The dissent further challenged the holding that the shared responsibility payment is valid under Congress's taxing power. In distinguishing the precedent cited by the majority, the dissent found that "[w]e have never held that any exaction imposed for violation of the law is an exercise of Congress's taxing power – even when the

statute calls it a tax, much less when as here, the statute repeatedly calls it a penalty... . To say that the individual mandate merely imposes a tax is not to interpret the statute but to rewrite it. Judicial tax writing is particularly troublesome."

The most compelling portion of the dissent was Justice Kennedy's statement that the majority engaged in "vast judicial overreaching...to save a statute that Congress did not write."

Conclusion

Notably, the only example of a tax on inactivity the Court mentioned in its decision related to capitations, an example of which is best provided by the poll taxes that once applied to all men at the turn of the century. The lack of more modern examples, as well as the lack of any precedent containing circumstances supporting the Court's ruling on taxing inactivity, highlights the truly expansive nature of its decision on Congress's Taxing Clause authority.

The future implications of the Court's decision with regard to such Congressional authority are unknown at this point. At a minimum, the majority opinion opens the door to speculation and fear about just how far and wide Congress's legislative net might reach if the Taxing Clause can serve as the "catch-all" basis to validate measures that even the Commerce Clause cannot support. Should you wish to discuss the Court's decisions in more detail, or wish to discuss the possible implications of such decisions, please contact any attorney in the Firm's Tax Department.