SCWA Legislative Update

June 28, 2021

Supreme Court Dismisses Latest Challenge to the Affordable Care Act

On June 17, 2021, the Supreme Court rejected the latest challenge to the Affordable Care Act (ACA).

The consolidated case of California, et al. v. Texas, et al. posed two critical questions for the Justices: (1) is the ACA's individual mandate unconstitutional now that there is no penalty for not buying insurance? and (2) if the individual mandate is unconstitutional, is the entire ACA unconstitutional?

In its decision, the Supreme Court didn't actually answer either question. Instead, in a 7-2 decision, the Court dismissed the case ruling that the parties challenging the ACA (eighteen states and two individuals) did not have standing to raise these issues.

Let's start with quick refresher on what this case was all about and what happened before it hit the Supreme Court -

The foundation of this case originated when the Tax Cuts and Jobs Act (TCJA) of 2017 reduced the penalty for non-compliance with ACA's individual mandate to zero. The parties challenging the ACA in the California v. Texas case argued that not only did this change render the individual mandate unconstitutional (because it no longer stems from Congress' power to tax) it also rendered the entirety of the ACA unconstitutional.

In December of 2018, a federal district court judge in Texas ruled in favor of the challengers holding that both the individual mandate and the ACA were unconstitutional in light of the TCJA change. The effect of the ruling was stayed and the case was promptly appealed to the 5th Circuit Court of Appeals.

Approximately a year later, in December 2019, the 5th Circuit upheld part of the District Court's decision and remanded the remainder back to the lower court for reconsideration. Specifically, the 5th Circuit agreed that the reduction of the individual mandate penalty to zero rendered the individual mandate unconstitutional. The appellate court did not reach a conclusion on the continued viability of the ACA as a whole and instead remanded that issue to the District Court instructing the District Court to conduct a more thorough analysis of which parts of the ACA could stand on their own, as severable from the unconstitutional individual mandate, and which were inextricably linked to the mandate and would therefore be themselves unconstitutional. In taking this action, the 5th Circuit stated that the District Court needed to "employ a finer-toothed comb" before reaching a conclusion on whether the ACA as a whole was unconstitutional. The 5th Circuit also instructed the District Court to consider whether the outcome should apply just to the states challenging the law or to the entire country. The 5th Circuit's decision was appealed by both sides before the District Court engaged in any reconsideration.

With the 5th Circuit issuing its decision in December of 2019, the big question at that time was whether the case would go to the Supreme Court before the November 2020 elections. The Supreme Court ultimately declined to fast track the case and heard oral arguments in the case on November 10, 2020.

Back to the Supreme Court's decision -

In a decision penned by Justice Breyer (joined by Justices Roberts, Thomas, Sotomayor, Kagan, Kavanaugh and Barrett) the Supreme Court reminded the parties that a party must have standing before the courts have the authority to adjudicate a claim. As the Court summarized "[a] plaintiff has standing only if he can 'allege personal injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested relief.'" Declining to consider the two underlying questions being raised, the Court concluded that "[n]either the individual nor the state plaintiffs have shown that the injury they will suffer or have suffered is 'fairly traceable' to the 'allegedly unlawful conduct' of which they complain."

Specifically, as to the two individuals who claimed to have been damaged because the individual mandate required them to purchase health insurance, the Court concluded that there was no traceable harm because, with the penalty at zero there is no mechanism for enforcing the penalty. In other words, that the individuals were injured by incurring costs to purchase insurance was not the result of actual or threatened enforcement of an unlawful act – because there is no potential for enforcement.

As to the states, the states claimed that they had suffered two types of injuries. First, indirect injuries caused by the fact that the individual mandate had increased the number of enrollees in state run insurance programs which increased costs for the state. Then, direct financial injuries in having to expend money to comply with various administrative and other related expenses to ensure ACA compliance. The Court concluded that increase in costs in state run programs was not traceable to the enforcement of the individual mandate. Further, the Court found the ACA requirements that the states complained had increased their costs were found in other parts of the ACA, not the individual mandate.

In sum, the Court concluded that none of the challengers had a traceable injury sufficient to establish standing and remanded the case to the lower Court to be dismissed. Thus, the now eleven year old ACA lives to stand another day, sparing Congress and the markets from the potential frenzy of trying to figure out how to respond to some or all of the ACA being struck down.

The Biden Budget

As most of you are probably aware, on May 28th, the White House released President

Biden's proposed 2022 Federal Budget. On the same day, U.S. Treasury released what is known as the Green Book, which details and scores the President's various tax proposals. These documents, which incorporate elements of the President's previously announced American Jobs Plan and American Families Plan, are the most detailed glimpses we have gotten thus into the nitty gritty of the President's proposals.

Of course, as we've seen time and time again, a President's budget proposal is just that – a proposal. Congress is free to entirely disregard it and go their own direction. However, particularly when the same party is in control of Congress and the White House, Congress is typically more inclined to pick and choose portions of the President's budget to incorporate into the appropriations bills that will emerge in the coming months.

So what are some the big things that we will now be watching for as negotiations for FY2022 get underway?

Revenue raisers, revenue raisers and revenue raisers…

President Biden's $6 trillion budget proposal includes significant investments in non-defense spending. Under the President's proposal, the Departments of Commerce, Education, and Health and Human Services and the Environmental Protection Agency would each see their budgets increase by more than twenty-percent with the Department of Education seeing the highest bump at 40%. The budgets for the Department of Defense and Homeland Security would be kept essentially the same from FY2021 and no agency would see notable reductions to their budgets.

In turn, the President's budget proposes to bring in $3.6 trillion in new tax revenue over the next 10 years through a number of tax changes, many of which would be highly contentious. If it were enacted as proposed (which simply will not happen), the proposal would result in a net tax revenue increase of $2.4 trillion (due to the extension and expansion of a number of tax credits such as the child tax credit). Even with this increase, it is estimated that the proposed budget would add $1 trillion to the federal deficit over the next decade.

The bottom line to all this is that – even if Congress were inclined to incorporate just some of the President's proposed spending increases – the focus will be on where to come up with the money to (at least partially) pay for these increases.

On the strictly corporate side, the President's budget proposes to increase the corporate tax rate to 28%. From what we've seen so far – this is a non-starter even amongst the President's own party. Senator Joe Machin (D-WV), whose vote will be essential to passing any legislation, has indicated that he is not comfortable with a 28% corporate tax rate though he could support a 25% rate. The proposal would also raise revenue through a number of changes to the way that businesses with international earnings are taxed.

The proposal is silent on Section 199A deduction for owners of closely held businesses. While it is a good thing that Section 199A is not being targeted for immediate elimination, the provision is set to expire in 2026 – at which time, depending on where the corporate tax rate stands, these closely held businesses would be placed at a severe disadvantage to their corporate counterparts. Even though the budget proposal does not specifically mention limiting Section 199A, there is some thought that this option may still surface as a pay-for by limiting this valuable deduction only to individuals who make less than $400,000.

Interestingly, the proposed budget would not change the gift or estate tax thresholds. Unfortunately, the same cannot be said of the capital gains tax system. The President has proposed taxing capital gains on assets going through an estate, in other words death would become an event that would trigger capital gains. Presently, not only are assets going through an estate not subject to a capital gains tax but they get a new “stepped-up” basis to the assets then fair market value. Upon a careful review of the somewhat sketchy guidance on the proposal that has come out thus far, it even appears that contributing property to a partnership would trigger capital gains as would removing property from a partnership. Even though this change is billed as only affecting the ultra-wealthy, it has the potential to wreak havoc on many small businesses, farms and ranches by requiring the payment of substantial taxes upon the death of the owner. For the first time in our nation’s history, death could cause the same asset to be taxed by estate taxes and by income taxes (capital gains tax).

Some of you may have seen an article this past week in ProPublica which has obtained data (allegedly leaked from the IRS) which shows how few taxes some of the wealthiest people in the United States pay. The article goes on to explain that one of the major reasons these individuals pay so little in taxes is that they continue to hold on to their capital assets so no tax is due even though their net worth continues to grow. This article seems to implicitly support President Biden’s proposal on taxing capital gains at death. While it may make sense to tax these gains for the wealthiest of all Americans, it certainly should not apply to small business owners, farmers and ranchers who year in and year out pay their fair share of taxes and then would get hit with an additional new capital gains tax at death or when removing assets from a partnership. At a minimum there should be a step up in basis of assets equal to the then current estate tax exemption. Small business associations are concerned about the impact that new capital gains taxes would have on small businesses and advocating that small business owners, farmers and ranchers not be swept up in an effort to tax the ultra-wealthy.

Despite pressure, the proposed budget does not eliminate the $10k cap on deductions for state and local taxes. A number of Democrats, particularly from those states with high state and local tax rates, have been placing serious pressure on the White House to include the elimination of the SALT cap in any proposal as a condition of garnering their support.

Again, the President’s budget is just an initial shot across the bow when it comes to what ultimately might end up in the appropriations and related bills. However, now that these options have been laid on the table, it would be a mistake not to take them seriously. With the same party in control of both sides of Pennsylvania Avenue, there is a much greater chance of things moving, and quickly, than there has been in prior years.

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