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ACA, Unconstitutionality and the Statute of Limitations — Sorting Out the Potential Mess

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INTRODUCTION

The cornerstone of President Obama's domestic agenda came to fruition in 2010 with the passage of The Patient Protection and Affordable Care Act, enacted March 23, 2010, and the Health Care and Education Reconciliation Act of 2010 (the ''HCERA''), enacted March 30, 2010 (hereinafter collectively referred to as the ''ACA'').[1]

According to a 2019 report by the Center on Budget and Policy Priorities, approximately 20 million people have gained health coverage under the ACA, and the percentage of the U.S. population without health insurance has been lowered to under 10% in 2017.[2]

While the passage of the ACA afforded greater access to health care coverage for a percentage of the population, questions were raised about such coverage would be financed. Altogether, the ACA is financed by the enactment of 21 different taxes and penalties, as well as by various government spending cuts.[3]

Among such revenue increases, the ACA requires employees to pay a tax equal to 0.9% of their wages exceeding prescribed thresholds (the ''Hospital Insurance Tax''),[4] as well as a 3.8% surtax on various forms of investment income subject to prescribed thresholds (the ''NII Tax'').[5] The ACA also requires U.S. citizens and legal residents, unless exempted, to either maintain minimum essential coverage or pay a shared responsibility payment pursuant to §5000A (the ''Failure to Comply Penalty'').[6]

According to a 2014 report from the Congressional Budget Office, the ACA increased taxes for the wealthiest one percent of taxpayers by approximately $21,000 per year, which decreases this group's average annual income by about 1.2%. The wealthiest 20% of taxpayers paid an average of an additional $1,100 in taxes. The corollary is that the ACA redirected more than $16 billion to the taxpayers in the poorest income bracket. The ACA increased the average income of those in the lowest tax bracket by $690 per person, and the average income of those in the second-lowest income bracket by an average of $560 per person.[7]

Beginning almost instantly after passage of the ACA, the political divisions spurred judicial challenges seeking to invalidate certain provisions of the

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[1] Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the I.R.C. and 42 U.S.C.), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

[2] https://www.cbpp.org/research/health/chart-book-accomplishments-of-affordable-care-act.

[3] O'Connell, *New Taxes Under the Affordable Care Act*, Investopedia.com (June 25, 2019). *See also* Stark, *How Is Obamacare Paid For?* (Nov. 1, 2016), https://money.com/collection-post/how-is-obamacare-paid-for/.

[4] §3101(b)(2). All section references herein are to the Internal Revenue Code of 1986, as amended (the ''Code''), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

[5] §1411(a).

[6] *See generally* Cowart, 330-1st T.M., *Tax and ERISA Implications of Employer-Provided Medical and Disability Benefits*, XIX.

[7] Stein, *Obamacare Jacked Up Taxes on the 1 Percent, Gave $16 Billion Annually to Poor*, Washington Post (Mar. 28, 2018).

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ACA or even to strike the entire ACA as unconstitutional.[8] One of the elements of the ACA — the Failure to Comply Penalty (which is better known as the "individual mandate" that sets forth the minimum requirements for individual health care coverage and the penalties for the failure to purchase such coverage) — was the subject of a U.S. Supreme Court decision within two years of the ACA's passage. In *National Federation of Independent Bus. v. Sebelius*,[9] the Supreme Court upheld the constitutionality of the individual mandate as an exercise of Congress' taxing power. The Supreme Court opined that the individual mandate could be read as a tax on an individual's decision not to purchase insurance, which was therefore a constitutional exercise of Congress's taxing powers under Article I of the United States Constitution.[10] The Tax Cuts and Jobs Act of 2017 (TCJA), enacted by a Republican-controlled legislative and executive branches of government, negated the punative impact of the individual mandate by reducing the Failure to Comply Penalty to zero dollars.[11]

Armed with the elimination of the Failure to Comply Penalty, ACA opponents again attempted to declare the individual mandate to be unconstitutional. In *Texas et. al. v. United States et. al*,[12] ACA opponents focused on the principle that the individual mandate was no longer constitutional because, as a result of the TCJA, the shared responsibility payment would no longer produce revenue for the federal government. The lack of an actual tax it more difficult — if not impossible — to claim that the individual mandate was constitutional under Congress' taxing power. It was further argued that no provisions of the ACA are severable, so that if one provision of the ACA is unconstitutional, the entire ACA must be unconstitutional. In the first major victory for the ACA opponents, the Northern District of Texas agreed with the Plaintiffs and held, among other holdings, that the individual mandate was unconstitutional and that ACA was not severable. On appeal, the 5th Circuit Court of Appeals upheld the unconstitutionality decision as to the individual mandate, but remanded to the district court on the issue of severability.[13] The decision was appealed to the Supreme Court in the now-consolidated case titled *California et. al. v. Texas et. al*,[14] with the focus on the severability question. On June 25, 2020, the Trump Administration filed its brief with the Supreme Court advocating, among other arguments, that such severance cannot occur within the ACA such that if one portion of the ACA is unconstitutional, the entire ACA is therefore unconstitutional.

If the Trump Administration's argument is successful without remand back to the district court, the ACA and all taxes and penalties imposed under it will be held to be unconstitutional. Putting aside the catastrophic effect of the loss of health care by millions of individuals, such a decision could place an additional strain on the federal budget in terms of federal income tax refunds. This article will explain some of the taxes and penalties generated by the ACA, the effect of an unconstitutional determination on a federal statute, and the post-determination procedures for seeking a refund of a tax previously assessed under a now-unconstitutional tax.

ACA TAX PROVISIONS

What exactly is the degree of taxes that are affected if the ACA is rendered unconstitutional? While, as previously stated, there are 21 taxes or penalties assessed under the ACA, the main focus is on four of the more commonly known taxes and penalties. As stated above, for individuals, two of the taxes imposed by the ACA are the Hospital Insurance Tax, which, under §3101(b)(2), is an additional 0.9% hospital insurance tax on certain wages and the NII Tax, which, under §1411(a), is a 3.8% tax on certain "net investment income." Both taxes were implemented for all years beginning after December 31, 2012. In addition, the Failure to Comply Penalty under §5000A imposes a penalty based on certain income tax thresholds beginning in 2014. Finally, employers are faced with a penalty for not offering health coverage under §4980H.

A detailed analysis of these taxes and penalties is beyond the scope of this article. Rather, a basic overview is presented to give the reader the general concept of the particular tax or penalty.

Hospital Insurance Tax

Under §3101(b)(1), a tax is imposed on the income of every individual equal to 1.45% of the wages (as defined in §3121(a)) received by the individual with

[8] A recent example of such a challenge is found in *Texas et. al. v. Rettig et. al.*, No. 18-10545, (5th Cir. July 31, 2020), in which, in an opinion released as this article was preparing for publication, the Fifth Circuit rejected a constitutional challenge to the "Provider Fee" enacted by §9010 of the ACA assessed against certain managed-care organizations.

[9] *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 132 S. Ct. 2566 (2012).

[10] *See generally Sebelius,* 567 U.S. 519 at 557-58.

[11] Pub. L. No. 115-97, §11081, applicable for months beginning after December 31, 2018.

[12] *Texas et. al. v. U.S., et. al.,* 340 F. Supp.3d 579 (N.D. Tex. 2018).

[13] *Texas et. al. v. U.S., et. al.*, 945 F.3d 355 (5th Cir. 2019).

[14] *California et. al. v. Texas et. al.*, ___ U.S. ___, 140 S. Ct. 1262 (2020).

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respect to employment (as defined in §3121(b)). The ACA expanded this tax with §3103(b)(2), which imposes an additional tax, referred to in this article as the Hospital Insurance Tax, equal to 0.9% of wages received with respect to employment during any taxable year which are in excess of, (1) in the case of a joint return, $250,000, (2) in the case of a married taxpayer filing a separate return, $125,000, and (3) in any other case, $200,000. The threshold amounts are not adjusted for inflation.

The following is a simple example of the calculation of the Hospital Insurance Tax:

> A, a single taxpayer, has gross income for 2020 of $650,000, comprised of wages of $300,000 (all of which are wages received with respect to employment as defined in §3121(b)) and income from investments and gains of $350,000.

The Hospital Insurance Tax is calculated as follows:

> A's wages of $300,000 are reduced by a reduction amount of $ 200,000 for a single, unmarried taxpayer, resulting in a net amount of $100,000, which is multiplied by 0.9% for a Hospital Insurance Tax amount of $900.

Net Investment Income Tax

Under §1411, the NII Tax can generally be described as a 3.8% tax assessed against a portion of an individual's income comprised of mostly passive investment sources. The tax is calculated on the lesser of, (1) the individual's ''net investment income,'' or (2) the excess of the individual's ''modified adjusted gross income'' over the ''threshold amount.''

The calculation methodology is fairly complex.

The first calculation, which, for this purpose is called the ''NII Calculation,'' involves the determination of ''net investment income'' under §1411(c), which, stripped down to its basics, is net investment income (1411 Income) reduced by net investment deductions (1411 Deductions). 1411 Income is determined under §1411(c)(1)(A) as the sum of, (1) passive income received by the individual (i.e., not income from a trade or business), (2) certain trade or business income if the trade or business is a passive activity (within the meaning of §469) or is in the business of trading in financial instruments or commodities, and (3) the net gain includible in taxable income attributable to the disposition of non-trade or business property.

The 1411 Income is then offset under §1411(c)(1)(B) by the 1411 Deductions, which are those deductions ''properly allocable'' to the 1411 Income.[15] In general, these are the deductions that are allowed by Subtitle A of the I.R.C. (i.e., §1 through §1563) properly allocable to the 1411 Income, gross income or net gain described in §1411(c)(1)(A). The Treasury regulations, primarily in Reg. §1.1411-4(f), §1.1411-4(g), and Reg.§1.1411-10(c)(5), expand on the types of ''properly allocable'' deductions, which encompass both the above-the-line deductions (i.e., those described in §62) and the below-the-line deductions.

The second calculation, which, for this purpose, is called the ''Threshold Calculation,'' is found in §1411(a)(1)(B) and involves determining the excess of the individual's ''modified adjusted gross income'' over the ''threshold amount.''

''Modified adjusted gross income'' is defined in §1411(d) as an individual's adjusted gross income increased by the excess of, (1) the amount excluded from gross income under §911(a)(1) (pertaining to U.S. citizens or residents living abroad) §1411(d)(1)), and §1411(d)(2) the amount of any deductions (taken into account in computing adjusted gross income) or exclusions disallowed under §911(d)(6) with respect to the amounts described in §1411(d)(1).

The ''threshold amount'' is established under §1411(b) as, (1) $250,000, in the case of a joint return or surviving spouse, (2) $125,000, in the case of a married individual filing a separate return, and (3) $200,000 for a single taxpayer or a taxpayer filing as head of household. The ''threshold amount'' is not adjusted for inflation.

The following is a simple example of the calculation of the NII Tax:

> Assuming the same facts as the prior example, all of A's income from investments and gains of $350,000 is determined to be 1411 Income. A's deductions for 2020 are $50,000, and are all assumed to be 1411 Deductions. None of the exceptions under §1411 are applicable, and none of A's income is subject to the provisions of §911.
>
> The NII Tax is calculated as follows: The NII Calculation is A's 1411 Income of $350,000 reduced by A's 1411 Deductions of $50,000, resulting in an NII Calculation amount of $300,000. The Threshold Calculation is A's modified adjusted gross income, which is $650,000, reduced by the threshold amount, which, as a single taxpayer, is $200,000, resulting in a Threshold Calculation amount of $450,000.
>
> The NII Tax is 3.8% of $300,000 (which is the NII Calculation amount of $300,000, since it is lower

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[15] *See generally* Kirk, 511-1st T.M., *1411 — Net Investment Income Tax*, V.A.

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than the Threshold Calculation amount of $450,000), or $11,400.

Suppose that A's gross income for 2020 is only $210,000, of which $50,000 is 1411 Income, and A's deductions, all of which are 1411 Deductions, are only $20,000.

The NII Calculation is A's 1411 Income of $50,000 reduced by A's 1411 Deductions of $25,000, resulting in a NII Calculation amount of $25,000. The Threshold Calculation is A's modified adjusted gross income, which is $210,000, reduced by the threshold amount, which, as a single taxpayer, is $200,000, resulting in a Threshold Calculation amount of $10,000.

The NII Tax is 3.8% of $10,000 (which is the Threshold Calculation amount of $10,000, since it is lower than the NII Calculation amount of $25,000), or $380.

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Failure to Comply Penalty — the "Individual Mandate"

Effective for 2014 and beyond, the ACA includes a mandate that requires most individuals to either have health insurance or pay a tax penalty with respect to any month during which such individuals fail to maintain ''minimum essential coverage'' (MEC) for themselves and their dependents.[16] As stated above, beginning in 2019 and thereafter, the TCJA reduced the penalty amount to zero dollars.

There are many facets to the calculation of the Failure to Comply Penalty. Under §5000A(c), the penalty for failing to maintain the MEC is the greater of, (1) a percentage of the amount by which household income exceeds the income tax return filing threshold for the applicable tax year, and (2) a flat dollar amount assessed on each taxpayer and any dependents. The percentage penalty amount based on applicable income is 1.0% in 2014, 2.0% in 2015, 2.5% in 2016, 2017, and 2018, and is reduced to 0% by the TCJA beginning in 2019. The annual flat dollar amount was phased in — $95 in 2014, $325 in 2015, $695 in 2016, 2017, and 2018.[17] The total penalty for a family is capped at 300% of the flat dollar amount. The flat dollar amount is reduced by one-half for dependents under the age of 18. Finally, the penalty for noncompliance cannot exceed the national average premium for bronze-level qualified health plans offered through exchanges (for the relevant family size).[18]

Impact on Employers

The ACA's financial impact is not limited to affecting individual taxpayers; employers are also impacted. While the ACA does not require an employer to offer health care coverage, the ACA imposes penalties on certain employers who do not offer coverage. Employers are potentially subject to one of two separate penalties for the failure to comply with the ACA's mandates regarding offering health coverage and offering coverage to employees who qualify for premium tax credits or cost sharing reductions. These are often referred to as the ''Employer Shared Responsibility'' penalties, and are found in §4980H.

As initially enacted by the ACA, if certain ''applicable large employers'' (ALE) fail to provide employees (and the employee's dependents) with the opportunity to enroll in minimum essential coverage under an eligible employer-sponsored plan for a particular month, such employers would be subject to penalties as calculated under §4980H(a). Employer penalties increase in proportion to the amount of federal tax dollars expended to subsidize health care premiums and benefits accessed by the employer's low-income employees who seek affordable coverage.[19] Under the flush language of §4980H(a), the penalty is equal to the product of the ''applicable payment amount'' (APA) and the number of individuals employed by the employer as full-time employees during such month.

In addition, if certain ALEs offer health coverage enrollment to its full-time employees (and such employees' dependents) and at least one of such employees has been certified to the employer under §1411 of the ACA[20] as having enrolled for such month in a qualified health plan with respect to which an applicable premium tax credit or cost-sharing reduction is allowed or paid with respect to the employee, the employer is subject to a penalty determined under §4980H(b). Under the flush language of §4980H(b), the penalty is equal to the product of the number of full-time employees of the applicable large employer for such month and an amount equal to 1/12 of $3,000.

Section 4980H(c)(1) defines the APA as, with respect to any month, 1/12 of $2,000.

Pursuant to §4980H(c)(2)(A), an ALE is an employer who employed an average of at least 50 full-time employees on business days during the preceding calendar year. Under §4980H(c)(2)(A), ALEs do not include certain employers whose workforce only exceeded 50 full-time employees for 120 days or fewer during the calendar year and if the employees in excess of 50 employed during such 120-day period were seasonal workers. However, in determining the number of ''full-time employees'' for purposes of the penalties, §4890H(c)(2)(D) reduces the number by 30.

Finally, the dollar amounts used in determining the Employer Shared Responsibility penalties are adjusted for inflation under §4980H(c)(5). For 2020, these thresholds are $2,570 for the §4980H(a) penalty and $3,860 for the §4980H(b) penalty.[21]

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[16] Bianchi, 332-1st T.M., *Employer Shared Responsibility*, II.E. — Individual Mandate.

[17] For years after 2016, the $695 amount was to be indexed to the CPI-U, rounded to the next lowest multiple of $50, but the 2017 and 2018 amounts were nevertheless calculated to be $695.

[18] Bianchi, 332-1st T.M., *Employer Shared Responsibility*, II.C.

[19] Bianchi, 332-1st T.M., *Employer Shared Responsibility*, II, Preamble.

[20] It is important to understand that this reference is to §1411 of the ACA and not §1411 of the I.R.C.; §1411 of the ACA is 42 U.S.C. §18081 and it titled, ''Procedures for Determining Eligibility for Exchange Participation, Premium Tax Credits and Reduced Cost-Sharing, and Individual Responsibility Exemptions.''

[21] IRS FAQ, *Questions and Answers on Employer Shared Responsibility Provisions Under the Affordable Care Act,* https://www.irs.gov/affordable-care-act/employers/questions-and-

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UNCONSTITUTIONALITY AND "VOID AB INITIO"

Bouvier's Law Dictionary defines "*void ab initio*" as:

> "Void from the very start. *Void ab initio* is voidness in an instrument, writing, claim, or other apparent source of an obligation, that reaches back to the source's creation, declaring the source and all of its intended effects to have been void all along, that whatever effects that had followed from it were unjustified by it, and potentially giving rise to an action for restitution or rescission or other remedy to restore the parties affected by it to the position they would have been in without it. Voidness *ab initio* affects any instrument or doctrine that was improperly created or created without proper authority. Thus, *a statute that is found unconstitutional is void ab initio*; a contract that was procured by fraud is void ab initio, as is a marriage by a bigamist."[22]

When a statute is declared to be "unconstitutional," the general rule is that the statute, though having the form and name of law, is in reality not law and is wholly void and ineffective for any purpose. Further, since unconstitutionality dates from the time of enactment and not merely from the date of the decision, an unconstitutional law, in legal contemplation, is as inoperative as if it had never been passed and never existed so as to be *void ab initio*.[23] If the statute never existed, the effect of the statute — whether it prohibited an action or imposed an action, such as the assessment of a tax, should never have occurred. This means that, as to a statute that imposes a tax, if that statute is rendered unconstitutional, the tax collected by the imposition of the statute should never have been collected.

Can this really occur as to a federal tax? In other words, "*void ab initio*" is a nice, legal theory, but is this really the result with respect to a tax? Recent history answers this affirmatively.

Consider the ramifications of the 2013 Supreme Court decision in *United States v. Windsor*.[24] In a 5-4 decision, the Supreme Court rendered §3 of the Defense of Marriage Act (DOMA)[25] to be unconstitutional as it purported to define "marriage" as recognized under federal law as only between a man and a woman. The majority opinion did not delve into a constitutional analysis, but rather summarized the issue, stating that DOMA was unconstitutional as a deprivation of an individual's liberty and therefore, a violation of the Fifth Amendment.[26] "Marriage," as this is a state law concept, is best left to be defined by the states.[27]

Although the crux of the *Windsor* decision pertained to the disallowance of the federal estate tax marital deduction under §2056, its effects are far reaching under federal law. The reason for this is that DOMA was part of the definitional sections of the United States Code, which means that any reference to "marriage" throughout the United States Code refers back to 1 U.S.C. §7. Thus, unless excepted by a specific definition, every Federal civil statute, employment statute, criminal statute, and tax statute, defines "marriage" pursuant to 1 U.S.C. §7.

As to the tax ramifications of *Windsor*, consider the following hypothetical:

> After the 2004 change in the marriage laws in Massachusetts, A and B, same-sex partners, decide to marry in 2005. Wealth-wise, A is the bread-winner in the family with a large estate, whereas B has little or no assets. A dies suddenly on March 31, 2006, leaving the entire estate, valued at $10,000,000, in a trust, under which, (1) B receives all of the income therefrom, (2) the Trustees have the discretion to pay to B as much principal as B needs for B's health, support and maintenance, and, (3) upon B's death, the remainder is paid among A's blood heirs.

Absent DOMA, because A and B were married at the time of A's death, the trust for B would qualify under §2056(b)(7) as "qualified terminable interest property" and would be eligible for the federal estate tax marital deduction. As a result of DOMA, however, A's executors could not have elected QTIP treatment because B, even though B was legally married to A in Massachusetts, was not considered to be married for federal tax purposes, and, as a result, on December 31, 2006, A's executors file A's federal estate tax return (the "706") and, ignoring deductions and apply-

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answers-on-employer-shared-responsibility-provisions-under-the-affordable-care-act#Liability.

[22] Sheppard, *Void ab Initio*, The Wolters Kluwer Bouvier Law Dictionary Desk Edition — ETTOC (Emphasis added).

[23] 16A AM. Jur. 2d *Constitutional Law* §195 (updated May 2012).

[24] 570 U.S. 744 (2013).

[25] Pub. L. No. 104-199, §3(a) (Sept. 21, 1996), 110 Stat. 2419. (1996) (creating 1 U.S.C. §7).

[26] For all purposes of this article, "Amendments" and "Clauses" shall refer to Amendments and Clauses to the United States Constitution.

[27] For an analysis of the *Windsor* decision and its effect on various federal and state taxation and estate planning provisions, see generally Karibjanian, *Same-Sex Marriage and Estate Planning: Nope, It's Not Over Yet!*, presented at the American Bar Association's Section of Taxation and the Real Property, Trust & Estate Section 2016 Joint Fall CLE Meeting, September 29, 2016, in Boston, Massachusetts.

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ing the rates and exemptions applicable in 2006, pay $3,680,000 in federal estate taxes.

With the *Windsor* opinion, the definition of marriage under DOMA has been rendered unconstitutional. However, as of June 26, 2013, which is the date of the *Windsor* opinion, the statute of limitations for amending A's Form 706, as discussed in the next section of this article, had expired.

Upon reading the decision, B visits an attorney and asks, ''hey . . . if 'unconstitutional' means that the statute was void*ab initio,* i.e., void from the outset so it should be treated as if it never existed, shouldn't A's trust for me have qualified for the marital deduction? What about those years where we had to file our individual tax returns as single individuals even though we were married — if the law stating that the federal government would not recognize our marriage is unconstitutional, then this must mean that we were married for federal tax purposes, and, if so, what if we would have paid less tax if we were allowed to file jointly?''

While these questions — and others — are valid questions, the issue was whether the IRS would acknowledge the void *ab initio* effect of the *Windsor* decision on federal taxes. Two months after the June 2013 issuance of the *Windsor* opinion, the IRS addressed the issue with its release on August 29, 2013, of Rev. Rul. 2013-17[28] and IR-2013-72,[29] which stated, in part, that same-sex married couples may file for federal refunds.[30] While the IRS's conclusions were probably already assumed by practitioners in that technically, Rev. Rul. 2013-17 did not add anything new, it inferred the IRS's acknowledgment that the unconstitutionality of a tax statute affords individuals affected by the unconstitutionality the ability to recover the unconstitutional taxes paid.

UNCONSTITUTIONALITY AND THE ACA

Since the concept of void *ab initio* is applicable in terms of the unconstitutionality of a federal statute, the analysis shifts to how this would be applied if the ACA were determined to be unconstitutional.

With respect to an analysis of tax returns on which the taxes were reported, one of two scenarios would occur — a review of a return where the statute of limitations is open and a review of a return where the statute of limitations has been closed.

The Statute of Limitations — Section 6501

Under the I.R.C., the statute of limitations for review of transactions in a particular tax year is found in §6501.

As previously stated, the general rule is contained within §6501(a), which states that the statute of limitations for collection and assessment is three years after the applicable return was filed (regardless of whether such return was filed on or after the date prescribed). There are exceptions to the general rule. The most notable exceptions are found in §6501(c)(1) and §6501(c)(2), which suspend the statute of limitations if a false return is filed or a willful attempt is made to evade a tax. Another exception, well known to practitioners but perhaps less known to individual taxpayers, is found in §6501(e)(1), which generally provides that if the total omissions from the taxpayer's return exceed 25% of the amount of gross income stated on the return, the three year limitation is extended to six years.[31]

The statute of limitations for refunds, however, is slightly different than the statute of limitations on assessment. Pursuant to §6511(a), a claim for credit or refund of an overpayment of any tax in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within three years from the time that the return was filed or two years from the time the tax was paid, whichever of such periods expires later, or if no return was filed by the taxpayer, within two years from the time the tax was paid. In most instances, the statute of limitations for claiming a refund is the same as it is for an assessment —three years from the filing of the return. However, if circumstances are such whereby a taxpayer paid any tax after the filing of the return such that the date that is two years from the payment of the tax is after the third year anniversary from the filing of the return, the taxpayer may still claim a refund for such payment.

Claiming the Refund in an Open Year

If the ACA is deemed to be unconstitutional, any taxpayer who paid any taxes or penalties with respect to the ACA has arguably paid a tax or penalty based on a law that is deemed never to have existed. The taxpayer has justification to claim a refund for such payments.

With respect to the open tax years, based on recent past history, the IRS would agree with this conclusion.

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[28] Rev. Rul. 2013-17, Rev. Rul. 2013-38.

[29] IR-2013-72 (Aug. 29, 2013).

[30] As a part of its four-pronged reasoning, the IRS stated that the Supreme Court's opinion in *Windsor* suggests that the Supreme Court understood that its decision striking down §3 of DOMA would affect tax administration in ways that extended beyond the estate tax refund at issue.

[31] Section 6501(e)(2) provides for a similar extension with respect to an estate or gift tax return, extending the statute of limitations to six years if the omission exceeds 25% of the gross estate or total taxable gifts reported on the return.

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As previously stated, the Supreme Court determined that DOMA was unconstitutional, the IRS issued Rev. Rul. 2013-17 and IR-2013-72 to provide guidance for same-sex married taxpayers to claim refunds for any taxes that were paid as a result of federal DOMA laws. The IRS gave credence to the proposition that an unconstitutional determination renders a statute as inoperative as if it had never been passed and never existed so as to be void *ab initio*.

Applying this to the present issue, such a determination of unconstitutionality would allow a taxpayer to file amended returns and claim refunds for such prior open years based on the law as it now exists as to such time period, i.e., as if the applicable statute were not then in existence.

Claiming the Refund in a Closed Year — Is this Possible?

Rev. Rul. 2013-17 and IR-2013-72 only applied to tax years that were open at the time. Left unresolved was the question of whether taxpayers have any recourse if a particular tax year is closed.

The Supreme Court usually releases opinions toward the end of its term.[32] If that were to occur with the *California* case, an opinion would be released in May or June 2021. By then, most initial 2021 tax filing deadlines for individuals and employers not on a fiscal year would have passed, which means that, absent extensions of time, the open tax years would be 2018, 2019, and 2020, and 2013 through 2017 would be closed years.

The question, then, is whether it is possible to reopen those closed years based on the unconstitutionality determination.

Before engaging in the analysis, it is imperative to understand that unconstitutionality must be distinguished from a repeal or reformation of a statute. Unless otherwise stated in the statute, a repeal of a tax is a proactive measure by a legislature intended for prospective application (unless the legislation specifically indicates a retroactive application). The legislature has made no acknowledgment on the constitutionality of the particular statute, but it has determined that the statute should no longer apply prospectively. Unconstitutionality, however, is a judicial determination whereby the statute was legally invalid and never should have existed.

With respect to amended returns, there is no current requirement under the I.R.C. or Treasury regulations for a taxpayer to file an amended tax return.[33] The primary reference is a statement contained in the Treasury regulations stating that, in certain circumstances, a taxpayer "should" file an amended income tax return.[34]

The same hypothetical described above under the *Windsor* analysis can be applied to a potential ACA unconstitutionality determination. Query as to how a statute of limitations can be imposed to bar a refund collection if the original tax paid was an unconstitutional tax. In other words, from a constitutional standpoint, does the unconstitutionality of the statute take precedence over the statute of limitations?

Distinguishing from Common Constitutionality Arguments

In recent history, a tax law analysis of constitutionality seemingly has been determined as to the retroactivity of a tax or assessment. For example, recall in 2010 when, pursuant to the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001,[35] the federal estate tax was repealed in 2010, and would re-surface in 2011 under the rules as in effect in 2001. During 2010, much discussion centered on whether an estate tax would be implemented on a retroactive basis for 2010. Tax literature was wrought with articles and discussions on the constitutionality of any such legislation.[36]

The difference between such discussions and an unconstitutionality determination is that all such discussions focused on the retroactive impact of an additional tax or new legislation; what was not discussed is the effect of a statute's determination of unconstitutionality on a prior tax liability, the effect of which would not be detrimental to the taxpayer, but actually would be beneficial to the taxpayer.

Supreme Court Chimes in as to State Tax Issues[37]

While there do not appear to be any Supreme Court decisions affecting a federal statute on this topic, the

[32] https://www.uscourts.gov/about-federal-courts/educational-resources/about-educational-outreach/activity-resources/supreme-1.

[33] *See, e.g.,* Harrington, as updated by Moore, *Selected Procedural Issues in Estate and Gift Tax Controversies*, ALI-ABA Course of Study, Estate Planning in Depth, 651 (June 2006).

[34] *See* Reg. §1.461-1(a)(3) (where a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, the taxpayer should file an amended return).

[35] Pub. L. No. 107-16, Economic Growth and Tax Relief Reconciliation Act of 2001 (June 7, 2001).

[36] For example, see Pratt and Bowman, *Retroactive Transfer Tax Legislation: Constitutional or Unconstitutional?*, LISI Estate Planning Newsletter #1573 (Jan. 6, 2010); Beth Shapiro Kaufman, *2010: The Anatomy of a Train Wreck,* 37 Estate Planning Journal No. 05, 42 (May 2010).

[37] A portion of this analysis is derived from Siske, Maryn, and

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Supreme Court has discussed the issue of unconstitutionality as to state tax statutes.

McKeeson Corp. v. Division of Alcoholic Beverages and Tobacco, Dept. of Business

In *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Dept. of Business*,[38] wholesale liquor distributors in Florida filed suit, challenging a Florida excise tax that gave preferential treatment to beverages that were manufactured from Florida-grown citrus and other agricultural crops and then bottled in state. The Florida lower courts invalidated the tax scheme under the Commerce Clause. Upon appeal to the Florida Supreme Court, the lower court decisions were upheld, but the Florida Supreme Court did not provide any post-tax payment refunds. The liquor distributors then appealed the decision to the Supreme Court.[39]

In its decision, the Supreme Court found in favor of the liquor distributors. If a state penalizes taxpayers for failure to remit their taxes in a timely fashion, thus requiring them to pay first and obtain review later, the Due Process Clause of the Fourteenth Amendment requires that the state afford a meaningful post-payment remedy for taxes paid pursuant to an unconstitutional tax scheme. The remedy to a distributor for having paid taxes higher than those paid by favored competitors would require a refund of the excess tax or a partial retroactive assessment of tax increases on the favored competitors.

In describing the available remedies for the state in this instance, the Supreme Court stated that:

> And in the future, States may avail themselves of a variety of procedural protections against any disruptive effects of a tax scheme's invalidation, such as providing by statute that refunds will be available to only those taxpayers paying under protest, or *enforcing* relatively short statutes of limitation applicable to refund actions . . . Such procedural measures would sufficiently protect States' fiscal security when weighed against their obligation to provide meaningful relief for their unconstitutional taxation. (Emphasis added.)[40]

By the emphasized statement, the Supreme Court is apparently stating that for closed tax years, while the tax is unconstitutional, if a state imposes a remedy in the form of a statute of limitations or a way to stay the statute of limitations, this should prevail over an unconstitutionality decision. The issue with this statement, however is that it does not appear to be part of the holding but rather is in the dicta discussing the conclusion. Query, then, if this is binding as Supreme Court precedent or is non-binding language subject to interpretation by other courts as to the effect of an unconstitutionality determination.

Subsequent decisions citing *McKeeson* include *Newsweek, Inc. v. Florida Dept. of Revenue*,[41] wherein a magazine publisher sought a refund of sales taxes following a determination that a tax exemption available for newspapers, but not magazines, was unconstitutional, *Stone Container Corp. v. United States*[42] (described below), and *Venture Coal Sales Co. v. United States*,[43] wherein the taxpayer argued that the accrual of a cause of action under the Tucker Act for refund of coal sales taxes when such taxes were paid, and not when the statute required payment of those taxes, was unconstitutional under the Export Clause.

Davis v. Michigan Dept. of Treasury

In *Davis v. Michigan Dept. of Treasury*,[44] Paul Davis, a Michigan resident and former federal employee, paid state income tax on his federal retirement benefits in accordance with the Michigan Income Tax Act, which exempts from taxation all retirement benefits paid by the State of Michigan or its political subdivisions, but taxes retirement benefits paid by other employers, including the federal government.

Mr. Davis filed for a refund, claiming that the taxation of Michigan employees vs. federal employees was discriminatory.

The Supreme Court held that Michigan's tax scheme violates principles of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees.

Harper v. Virginia Dept. of Taxation

In *Harper v. Virginia Dept. of Taxation*,[45] Henry Harper and his fellow plaintiffs, all of whom were federal civil service and military retirees residing in Virginia, challenged a Virginia tax statute similar to that found in the *Davis* decision and brought an action seeking a refund, citing *Davis*.

The Supreme Court concluded that its decision in *Davis* must be applied retroactively to the petitioner's claims for refunds; however, it ruled that its decision

Smith, *What's New In Employee Benefits: A Summary Of Current Case And Other Developments*, American Law Institute — American Bar Association Continuing Legal Education, ALI-ABA Course Of Study — Pension, Profit-Sharing, Welfare, And Other Compensation Plans (Oct. 12, 1995).

[38] 496 U.S. 18, 110 S. Ct. 2238 (1990).

[39] 524 So. 2d 1000 (1988).

[40] *McKeeson*, 496 U.S. 18 at 50, 110 S. Ct. at 2257.

[41] 522 U.S. 442, 118 S. Ct. 904 (1998).

[42] 229 F.3d 1345 (Fed. Cir. 2000).

[43] 370 F.3d 1102 (Fed. Cir. 2004).

[44] 489 U.S. 803, 109 S. Ct. 1500 (1989).

[45] 509 U.S. 86, 113 S. Ct. 2510 (1993).

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in *Davis* does not necessarily entitle the petitioners to a refund; rather, the Constitution requires Virginia to fashion relief consistent with the demands of constitutional due process.

Reich v. Collins

In *Reich v. Collins*,[46] the taxpayer, Charles Reich, a federal retiree, commenced an action under Georgia's tax refund statute, seeking recovery of state income taxes unconstitutionally assessed against federal retirement benefits when state retirement benefits were exempt from taxation. Georgia had taxed retirement benefits paid by the federal government, but exempted those paid by the State of Georgia, until the Supreme Court issued its decision in *Davis*. In response to the unconstitutionality of its statute, Georgia had repealed its state retiree tax exemption, but did not offer federal retirees refunds for the unconstitutional taxes they had paid prior to the *Davis* decision.

The Georgia Superior Court denied the refund request, and Mr. Reich appealed. The Georgia Supreme Court determined that the refund statute did not apply when the law under which taxes were assessed and collected was itself subsequently declared to be invalid.[47] Mr. Reich then petitioned for certiorari, and the Supreme Court remanded for further consideration,[48] after which the refund claim was again denied by the Georgia Supreme Court, which claimed that Georgia provided an adequate pre-deprivation remedy and thus due process did not require Georgia to provide refunds to the federal retirees.[49]

Upon the second certiorari, the Supreme Court, in a unanimous opinion, rejected the Georgia Supreme Court's analysis, concluding that a state may not reconfigure its remedy scheme in mid-course to avoid paying refunds. Terming the Georgia Supreme Court's analysis in the second *Reich* opinion as a ''bait and switch,'' the Supreme Court held that a state may not hold out a ''clear and certain'' post-deprivation remedy, in the form of its tax refund statute, and then declare, only after Reich and others had paid the disputed taxes, that no such remedy exists.[50]

Federal Taxes, Due Process, and the Ability to File a Protective Claim for Refund

Although the above-referenced cases refer to state statutes, can the same arguments be applied at the federal level?

Perhaps so — it is not outside the realm of possibility that the same ''Due Process'' arguments challenging state statutes based on the Fourteenth Amendment could also be presented challenging federal tax statutes based on the Due Process Clause in the Fifth Amendment. In other words, it may be possible that a taxpayer can use the same arguments from *McKeeson*, *Davis*, etc., and argue that the unconstitutionality of the ACA deprived him, her or it of property (i.e., tax dollars paid as a result of a void *ab initio* statute) without due process.

In the event that a case applies the Fourteenth Amendment arguments to the Fifth Amendment, taxpayers may be entitled to refunds for improperly paid taxes; however, as noted in the *McKeeson* and *Reich* opinions, relief may be limited based on the taxing authority's availability of a post-deprivation remedy. In the *Reich* opinion, the Supreme Court discussed a remedy and how the states can avoid liability for refunds beyond the applicable statute of limitations if their remedy is adequate.

Protective Claims for Refund

For federal tax purposes, the post-deprivation remedy can be found in the form of a ''protective claim'' for refund.

A protective claim for refund differs from an actual refund claim because the taxpayer does not want the IRS to act on the protective claim at the time it is filed. Protective claims are filed with the intention to toll the statute of limitations when either the law or the facts of the pending matter are still in flux. There is just one issue with the filing of a protective claim for refund — neither the I.R.C. nor the Treasury regulations has a specific provision authorizing the filing of a protective claim for refund. The authority has instead developed through case law and through procedures adopted by the IRS.[51]

While case law suggests that unconstitutionality should afford taxpayers a refund of any taxes collected as a result of the unconstitutional tax, the IRS could counter under *McKeeson* and *Reich* and argue that federal tax practices and procedures afford taxpayers the ability to anticipate this by the filing of a protective claim for refund. The IRS would advocate that the protective election approach is a valid ''post-deprivation'' remedy, so that, based on the Supreme Court precedence, the effect of the unconstitutionality

[46] 513 U.S. 106, 115 S. Ct. 547 (Dec. 6, 1994).

[47] 262 Ga. 625, 422 S.E.2d 846 (Ga. 1993).

[48] 509 U.S. 918, 113 S. Ct. 3028 (1993).

[49] 437 S.E.2d 320 (Ga. 1993).

[50] *Reich*, 513 U.S. 106 at 111.

[51] Much of the content for this paragraph is derived from Bowden, *Protective Claims for Refund: Protecting the Interests of Taxpayers and the IRS*, 56 Me. L. Rev. 149 (2004). With respect to the IRS procedures and pronouncements regarding protective claims for refund, *see* CCA 201136021 and Rev. Proc. 2011-48, authorizing the filing of a protective claim for federal estate tax purposes for deductions under §2053 by the filing of an IRS Form 706-PC.

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would be limited because the federal government has afforded taxpayers with an adequate post-deprivation remedy.

Support for Adequate Post-Deprivation Remedy? Stone Container Corp. v. United States

The ''protective claim for refund as a post-deprivation remedy'' question may have already been answered by the U.S. Court of Appeals for the Federal Circuit (the ''Fed CCA'') in *Stone Container Corp. v. United States*[52]

In the *Stone Container* decision, the Fed CCA applied the Fourteenth Amendment reasoning on this issue to a Fifth Amendment claim and ultimately rejected the taxpayer's argument that it is unconstitutional to apply a statute of limitations to an unconstitutional tax.

Stone Container Corp. (Stone), along with other corporations, brought an action to recover harbor maintenance taxes which they had paid to the federal government and which were deemed to have been unconstitutional, to which the government's actions were defended on the theory that corporations' lawsuit was filed outside of the two-year statute of limitations on such suits. Stone argued that it is unconstitutional to apply any statute of limitations to refund claims with respect to an unconstitutional tax, although, the Fed CCA noted, Stone did not explain why unconstitutional taxes, unlike other constitutional violations, should be free of statutes of limitations, but did argue that the remedy provisions in *McKeeson* were dicta and not binding.

In its analysis, the Fed CCA cited *McKesson's* Fourteenth Amendment Due Process analysis and stated that, although *McKesson* is based on the Due Process Clause of the Fourteenth Amendment, its principles are equally applicable to the federal government through the Due Process Clause of the Fifth Amendment (which seemingly acknowledges the applicability of *McKeeson*, *Davis*, *Harper*, and *Reich* to federal taxes). Further applying *McKeeson*, the Fed CCA denied Stone's argument, stating that in *McKeeson*, the Supreme Court stated that a state was free to impose various procedural requirements on actions for post-deprivation relief, including enforcing relatively short statutes of limitations applicable to such actions. When discussing Stone's argument concerning the statute of limitations, the Fed CCA acknowledged Stone's claim that the post-deprivation remedy language from *McKeeson* was ''mere dicta'' and that the Fed CCA is free to disregard it, but rejected the notion and failed to engage in the discussion, instead stating that as ''a subordinate federal court, we do not share the Supreme Court's latitude in disregarding the language in its own prior opinions.''

Counter-Argument — Remoteness

The argument against opening a prior year to claim a refund of an unconstitutionally incurred tax seems daunting. The Supreme Court has seemingly adopted the test that such re-openings are possible absent an adequate post-deprivation remedy, and if a post deprivation remedy is required, the IRS practices and procedures concerning a protective claim for refund seemingly satisfy the criteria for an adequate post-deprivation remedy. However, it could be argued that, in order to preserve a right, the taxpayer must be aware that the right exists. In other words, to what degree of knowledge in terms of ''remoteness'' must be applied in order to label a protective claim for refund as a ''post-deprivation'' remedy?

To again analogize to the *Windsor* opinion, with the hypothetical described above, was it reasonable for B to have assumed that, in 2006, federal DOMA laws would be judicially determined to be unconstitutional in 2013? The answer is ''highly unlikely.'' Applying this logic to the ACA, is it fair to presume that, in 2017, taxpayers should have presumed that the entire ACA would have been determined to be unconstitutional in 2021 so as to file protective claims for refund in 2017 for tax year 2013? Again, given the lack of success of opponents of the ACA in the courts at that time, it would be highly improbable that the ACA would have been held to be unconstitutional.

However, given the enhanced political strife that has occurred since 2017 and a seeming mandate by the current administration to eliminate every law from the Obama Administration[53] which, when combined with an influx of conservative federal judicial appointees, the possibility of an unconstitutionality determination has increased. As a result, the ACA issue may not be as clear-cut as the same-sex marriage issue in terms of remoteness.

Perhaps, though, another element must be added to the equation — one of ''reasonableness.'' In other words, is it reasonable to presume that a taxpayer would have known to file a protective claim for refund based on the persistence of plaintiffs who keep getting defeated in court? Based on this argument, it would be unreasonable to reach the conclusion that a taxpayer should have presumed unconstitutionality — the law was upheld numerous times by courts so why would a taxpayer presume that additional lawsuits would be successful? They wouldn't. If it is reasonable to conclude that a taxpayer should have filed for a protective claim for refund based on a court filing,

[52] 229 F.3d 1345 (Fed. Cir. 2000).

[53] Eilperin and Cameron, *How Trump is Rolling Back Obama's Legacy*, Washington Post (Mar. 24, 2017, updated Jan. 20, 2018).

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then it could then be argued that every taxpayer should always file a protective claim for refund against every tax assessed on the grounds that such a tax could someday be deemed to be unconstitutional and therefore, the taxpayer has to preserve his, her, or its rights to recover the unconstitutional tax. The irony is that such an action based on a ''reasonableness'' argument is actually unreasonable.

While many taxpayers would not consider the judicial route to protest the inability to collect any such taxes, it is not out of the realm of possibility that there could exist a taxpayer who is harmed to the degree where total theoretically unrecoverable unconstitutional taxes enter the seven or eight figures. Such a taxpayer would have the financial means to dispute the matter where it would ultimately find its way to the Supreme Court.

Rebuttal — Practicality

If faced with this analysis, the likely rebuttal from the IRS would be one of ''practicality.'' The IRS could simply argue that, while all of the above may be true, is it practical for economic reasons to entitle each and every taxpayer who may have been affected by the ACA to reopen closed tax years to claim a refund? If allowed, and given the scope of potential taxpayers impacted by the taxes and penalties associated with the ACA, would granting refunds end up hurting taxpayers more than it helps them? Consider the scenario that suppose on average, for each of 2013, 2014, and 2015, a total of 50,000,000 taxpayers are affected and the average refund due each taxpayer is $500. If the Supreme Court decision occurs in June 2021, this means that seven years would have passed since the 2013 taxes would have been paid, six years for 2014, and five years for 2015. The total refund per year would be $500 multiplied by 50,000,000 taxpayers, or $25 billion each year. Assuming a three percent interest factor for each year, the future value of such amounts would be $30.8 billion for 2013, $29.9 billion for 2014, and $29 billion for 2015, totaling $89.7 billion. Given the current pressure on the federal budget in connection with relief from the coronavirus pandemic, it is not unreasonable to presume that a court would find some justification for relief to be limited to open tax years in order to avoid further crippling the federal coffers.

CONCLUSION

With respect to same-sex married individuals in 2013, the pool of taxpayers affected by the *Windsor* decision is seemingly small when compared to the pool of total potential taxpayers. Thus, the decisions and rulings in light of the *Windsor* decision are generally academic when applied to the population at large. In my writings and analysis on the same-sex marriage issues, when discussing the effect of unconstitutionality on the ability to claim refunds, I wondered aloud if, in the near future, another provision affecting tax statutes is determined to be unconstitutional, what would happen if that particular tax statute affected a much larger sample size of the taxpaying population? Although I was speaking rhetorically, I certainly did not anticipate the issue to resurface a mere seven years later.

Should the ACA be determined to be unconstitutional, presumably millions of taxpayers would be entitled to refunds from the various taxes and penalties paid under an unconstitutional tax. For open years, the safest course of action is to file a protective claim for a refund. As this article is written in July 2020, for those taxpayers whose 2016 taxes were filed on extension in September or October 2017, the time is now to perhaps file for a protective claim for refund. For closed years, such taxpayers would have two options to seek a refund. First, they could use the analysis in *Stone* and argue that the post-deprivation remedy provisions in the *McKeeson* decision are mere dicta, so that unconstitutionality prevails over a statutory post-deprivation remedy, such as the ability to file a protective claim for refund to stay a statute of limitations. Second, they could acknowledge *Stone*, but argue that remoteness and reasonableness tests must be applied, which would negate and supersede the reliance on a statute of limitations as an available governmental remedy. This position takes the analysis to its logical conclusion by stating that to deem the protective claim for refund to be an adequate post-deprivation remedy would mean that each taxpayer must file a protective claim for refund for all matters in all years, which is impractical.

The likely rebuttal from the IRS would be that it is entirely impractical to award such refund given the financial strain that such an action would place on the federal finances.

Regardless of what happens, practitioners must be diligent in their advice to clients on this issue.

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