
Affordable Care Act – How a Potential Unconstitutionality Determination May Affect Your Taxes

We bring to your attention a case that is currently pending before the U.S. Supreme Court that may affect the taxes of millions of U.S. taxpayers. The case - *California, et al. vs. Texas et al.*¹ - addresses whether the Affordable Care Act (the “ACA”) is unconstitutional in its entirety. In a recent article published in Bloomberg Tax’s Tax Management Compensation Planning Journal, firm member George Karibjanian explained the significant tax ramifications if the Supreme Court holds the ACA to be unconstitutional, including potential claims for refunds on taxes paid to help fund the ACA.

It is important to note that neither George, nor this firm, is taking a position on whether the ACA should be ruled unconstitutional.

Specifically, the Supreme Court is being asked to determine, among other issues, whether the “individual mandate” provision of the ACA is unconstitutional and whether the provisions of the ACA can be severed.

The effect of an unconstitutionality determination is far reaching. If any law is determined to be unconstitutional, the legal effect is that the law becomes “void *ab initio*,” which means that the law is treated as if it never existed. If the particular law imposed a tax that a taxpayer previously paid, the unconstitutionality determination means that the statute imposing the tax is treated as if it never existed, which then means that the taxpayer never should have paid the tax.

Applying this to the ACA, the ACA imposed 21 different taxes and penalties. The 2 taxes that individuals most likely paid are, (a) the 3.8% surtax, imposed on investment income depending upon certain requirements, and (b) the wage tax of 0.9% for certain higher-income earners. If the Supreme Court determines that both that the individual mandate is unconstitutional and that the ACA cannot be severed, the ultimate conclusion reached by the Supreme Court is that the entire ACA is unconstitutional and would be stricken from the law.² If that were to occur, those who paid taxes and penalties under the ACA should technically have never have paid such taxes and penalties.

Under this scenario, shouldn’t those who paid the taxes and penalties be entitled to receive a refund? This seems logical – after all, if the law that imposed the taxes and penalties is deemed never to have existed, shouldn’t the IRS refund those improperly paid taxes and penalties to such taxpayers? Perhaps, but the IRS does not automatically refund unconstitutional tax payments; instead, the burden is on the taxpayer to request a refund.

By example, let’s say that Carol, who was liable for to the 3.8% surtax, properly and timely paid the tax and extended the filing her 2016 tax return to October 15, 2017. In that case, the usual 3-year statute of limitations for such return ends on October 15, 2020. If the ACA is declared unconstitutional in May 2021, Carol’s time to seek a refund of the taxes paid in 2016 will have passed. To preserve her right to seek a refund of the 3.8% surtax paid in 2016, she would have to file a “protective claim” for refund before the 3-year statute of limitations for tax year 2016 closes (i.e., by October 15, 2020).

The IRS, keenly aware of this issue, provided guidance earlier this year during the time when certain tax filings were suspended until July 15, 2020.³ The guidance provided that individuals must use Form 1040X and write on the top of

¹ *California et. al. v. Texas et. al.*, ___ U.S. ___, 140 S. Ct. 1262 (2020).

² You can Google “California v. Texas, individual mandate” and find an abundance of information on this litigation. *See generally*, Barnes, [Supreme Court refuses to fast-track a challenge to the Affordable Care Act](#), Washington Post (Jan. 21, 2020).

³ *See* <https://www.irs.gov/forms-pubs/due-date-to-file-a-protective-claim-for-tax-year-2016-individual-income-tax-returns-including-for-aca-has-been-postponed-until-july-15-2020>

the form “Protective Claim for refund under California, et al., v. Texas.” Therefore, the IRS is expecting taxpayers to file such protective refund claims all based on the possibility of the ACA and its taxes being declared unconstitutional.

What happens, though, to those taxes and penalties that were paid *outside* of the applicable statute of limitations – would refunds be available even though the statute of limitations for refund claims is closed? George’s article delves into this issue by comparing unconstitutionality with applicable statutes of limitation and discusses some of the arguments that could be made in a claim to disregard such statutes of limitations.

George’s article can be found on our firm’s website by clicking [THIS LINK](#).

If you have any questions, please ask us, or consult with your income tax professional.

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If you have any questions, please contact one of our lawyers.

RICHARD S. FRANKLIN [bio](#)
rfranklin@fkl-law.com

GEORGE D. KARIBJANIAN [bio](#)
gkaribjanian@fkl-law.com

LESTER B. LAW [bio](#)
lblaw@fkl-law.com

NIKKI DePERSIS [bio](#)
ndepersis@fkl-law.com

JUNE C. FAN [bio](#)
jfan@fkl-law.com

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