

Third Circuit: ACA Individual Mandate Payments Are Entitled to Priority Under the Bankruptcy Code

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Published on 16 May 2022 • USA (National/Federal)

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In a dispute involving the priority of individual mandate payments under the [Affordable Care Act](#) (ACA) in bankruptcy, the Third Circuit held that the payments are a tax entitled to priority status under the [Bankruptcy Code](#) (*In re Szczyporski*, (3d Cir. May 11, 2022)).

IRS's Proof of Claim Included ACA Individual Mandate Payments

The individual debtors in this case sought bankruptcy protection in 2019. The IRS filed a proof of claim asserting that the debtors owed more than \$900 for failing to maintain health insurance coverage in violation of the ACA's individual mandate during 2018 (26 U.S.C. § 5000A; see [Practice Notes, Affordable Care Act \(ACA\): Individual Mandate](#) and [Chapter 13 Bankruptcy: Overview](#)). The IRS characterized the payment as an excise tax that was entitled to priority under the Bankruptcy Code. The debtors, however, asserted that the payment was not a tax and therefore was not entitled to priority for bankruptcy purposes.

Relying on a 2012 Supreme Court decision, the bankruptcy court held that the disputed individual mandate payment was:

- A tax, rather than a penalty, for bankruptcy purposes.
- Entitled to priority under the Bankruptcy Code as an income or excise tax.

(*NFIB v. Sebelius* (567 U.S. 519 (2012)); see [Legal Update, Supreme Court Upholds the ACA's Individual Mandate.](#)) In *NFIB*, the Supreme Court held that the individual mandate payment was a tax for constitutional purposes.

Affirming the bankruptcy court, a district court:

- Agreed that the payment was a tax under the Supreme Court's *NFIB* ruling.
- Would also have found the payment to be a tax under Third Circuit precedent that uses a functional test to make this determination.

The district court concluded that the payment was entitled to priority only as an income tax (under Section 507(a)(8)(A) of the Bankruptcy Code) ([11 U.S.C. § 507\(a\)\(8\)\(A\)](#) ("Section 507")). (In the district court's view, however, the payment was not entitled to priority as an excise tax on a transaction—that is, under a related Section 507 provision.)

The debtors appealed.

Individual Mandate Payments Are a Tax for Bankruptcy Code Purposes

On appeal, the Third Circuit held that the individual mandate payment was a tax on or measured by income (under Section 507) for bankruptcy purposes. In reaching this conclusion, however, the court relied primarily on a six-factor test under Third Circuit precedent for determining whether a payment is a tax. The Third Circuit concluded that all six factors under this test indicated that the payment was a tax. Applying these factors, the court reasoned that:

- The individual mandate payment was:
 - an involuntary "pecuniary" burden imposed on individuals who failed to maintain health coverage that satisfied the ACA's individual mandate;
 - imposed by Congress;
 - levied for a public purpose—that is, expanding health insurance coverage;
 - imposed under Congress's taxing power; and
 - applied universally to similarly situated taxpayers.
- Granting the IRS priority status would not disadvantage similarly situated private creditors.

The Third Circuit noted that other factors also suggested the payment was a tax in the bankruptcy context. For example, taxpayers did not receive a specific benefit from the government in exchange for the payment, and the payments were calculated and administered like a tax. In addition, unlike a penalty, individual mandate payments did not impose a significant financial burden and could not be enforced through criminal prosecution.

The Third Circuit observed that the Supreme Court's analysis in *NFIB* was persuasive (though not dispositive) on the characterization question. Citing *NFIB*, the Third Circuit observed that individual mandate payments are determined and administered like a tax in that they:

- Are paid to the Treasury by taxpayers when they file their tax returns.
- Do not apply if an individual's household income is too low for the individual to be subject to federal income taxes.
- Are calculated using factors familiar to the tax context (for example, taxable income, number of dependents, and joint filing status).
- Are found in the Internal Revenue Code and enforced by the IRS.
- Are assessed and collected the same way that taxes are.
- Result in at least some revenue for the government.

The Third Court added that although the ACA statute labeled the payment as a penalty, the individual mandate lacked penal characteristics (for example, it was not enforced using criminal prosecution).

Individual Mandate Payment Was Entitled to Priority Under Bankruptcy Code

After concluding that the individual mandate payment was a tax for bankruptcy purposes, the Third Circuit next addressed whether it was entitled to priority under the Bankruptcy Code. The IRS argued that the payment should receive priority (under Section 507) as a tax measured by income. The Third Circuit agreed—though acknowledging that the payment was not a traditional tax on income earned. When the debtors incurred this obligation in 2018, the court reasoned, household income played an important role in calculating the individual mandate payment. Among other reasons, the Third Circuit noted that:

- Individuals owed no individual mandate payment if their household income was below a certain level (or below the level for filing a tax return).
- For those who owed the payment, the amount assessed depended in part on the individuals' household income—even in situations where the required payment was a flat fee rather than a percentage of income.

As a result, the Third Circuit concluded that the individual mandate payment was a tax measured by income and therefore entitled to priority status.

Practical Impact

As the Third Circuit recognized in its decision, not all courts that have addressed the question agree regarding whether the individual mandate payment is entitled to priority for bankruptcy purposes. Going forward, however, this question may arise less frequently—given that 2017 tax reform legislation reduced to zero the penalty for violating the ACA's individual mandate, effective beginning in 2019 ([Pub. L. No. 115-97 \(2017\)](#)); see [Tax Cuts and Jobs Act \(TCJA\) Compliance for Fringe Benefits and Health Plans Toolkit](#)).