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Introduction

The Patient Protection and Affordability Care Act (“ACA”) provides that certain individuals must maintain minimum essential health insurance coverage throughout the year.¹ If a person under the mandate fails to maintain the required insurance for one month or more, a shared responsibility payment (“SRP”) is imposed on the taxpayer.² The SRP is collected by the Internal Revenue Service (“IRS”).³

The Tax Cuts and Jobs Act (“TCJA”) eliminated the individual mandate and reduced the SRP to zero for 2019 and thereafter.⁴ The SRPs for 2018 and prior years must be reported to the IRS on the applicable tax return.⁵ Otherwise, the tax return will not be complete.⁶ Thus, SRPs owed before 2019 are a liability that the IRS may offset with any tax refund due by a taxpayer.⁷ The failure to pay an SRP gives rise to a claim the IRS can assert.⁸

¹ 26 U.S.C. § 5000A(a).

² *Id.* at § 5000A(b)(1).

³ *Id.* at § 5000A(g)(1).

⁴ Tax Cuts and Jobs Act, Pub. L. No. 115-97, §8 (2017).

⁵ Internal Revenue Service, *Individual Shared Responsibility Provision*, <https://www.irs.gov/affordable-care-act/individuals-and-families/individual-shared-responsibility-provision>.

⁶ *Id.*

⁷ *Id.*

⁸ Internal Revenue Service, Part 5. Collecting Process, https://www.irs.gov/irm/part5/irm_05-009-013r.

This article examines the potential tax status and priority of the shared responsibility payment under title 11 of the United States Code (the “Bankruptcy Code”). Part I examines the tax status of the SRP and Part II analyzes the potential priority of an unpaid SRP as a tax under the Bankruptcy Code.

I. The SRP is likely a Tax under the Bankruptcy Code.

A. The SRP is a Tax.

The United States Supreme Court has held that the SRP is a tax, not a penalty, within Congress’s taxing power.⁹ The Supreme Court noted that the ACA describes the SRP as a penalty (26 U.S.C § 5000A(b)(1)-(3)), however, it is not bound to that description.¹⁰ The Court noted that its precedent has found that exactions that were not labeled taxes were nonetheless authorized by Congress's power to tax.¹¹

The Court reasoned that the SRP has an essential feature of any tax, which is that it produces at least some revenue for the government.¹² The SRP is paid into the Treasury when an individual files their tax returns.¹³ The Supreme Court utilized a functional approach and found the SRP is a tax for three reasons.¹⁴ First, paying the SRP instead of purchasing health insurance could be a reasonable financial decision.¹⁵ Second, the individual mandate has no scienter requirement.¹⁶ Third, the SRP is collected solely by the IRS through normal means of taxation.¹⁷ Lastly, the Court referred to its precedent and found that “Congress had the power to impose the

⁹ Nat’l Fed. of Indep. Bus. V. Sebelius, 567 U.S. 519, 570 (2012).

¹⁰ *Id.* at 544 (“ . . . Congress cannot change whether an exaction is a tax or a penalty for *constitutional purposes* simply by describing it as one or the other.”).

¹¹ *Id.* at 564-565. See New York v. United States, 505 U.S. 144, 171 (1992); Quill Corp v. North Dakota, 504 U.S. 298, 310 (1992); United States v. Sotelo, 436 U.S. 268, 275 (1978).

¹² Nat’l Fed. of Indep. Bus. V. Sebelius, 567 U.S. at 564.

¹³ *Id.* at 563

¹⁴ *Id.* at 565.

¹⁵ *Id.* at 566.

¹⁶ *Id.*

¹⁷ *Id.*

exaction in § 5000A under the taxing power, and that § 5000A need not be read to do more than impose a tax. That is sufficient to sustain it.”¹⁸

According to the Supreme Court, a “tax” and not a penalty is an exaction, but it did not precisely define an exaction.¹⁹ The Court in *Nat’l Fed. of Indep.* did not address whether the SRP is a tax within the meaning of the Bankruptcy Code. However, the Court has utilized a “functional analysis” to determine whether an exaction was a tax for bankruptcy purposes.²⁰ When considering whether a particular exaction was a tax or not, a court can disregard the label of the exaction and determine its tax status based directly on the operation of the exaction.²¹ The Court did not provide further guidance on what is to be included in functional analysis, so courts have interpreted the functional analysis in different ways. The different interpretations are discussed below.

B. The Third and Fourth Circuits Agree that the SRP is a Tax.

The United States Court of Appeals for the Third Circuit and the Fourth Circuit have concluded that the SRP is a tax for purposes of the Bankruptcy Code. Those courts recognized that *Sebelius* does not address the SRP for bankruptcy purposes and found that *Sebelius* is not binding on a court’s tax analysis in the bankruptcy context. Instead, they utilized the functional analysis laid out by the Supreme Court in *U.S. v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213.

The United States Court of Appeals for the Third Circuit has held that the SRP is a tax for bankruptcy purposes.²² In *In re Szczyporski*, the Third Circuit applied the following six factors to determine if an exaction is a tax for bankruptcy purposes: (1) an involuntary pecuniary burden

¹⁸ *Id.* at 570.

¹⁹ *Id.* at 573.

²⁰ See *U.S. v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213, 224 (1996).

²¹ *Id.* at 220.

²² *In re Szczyporski*, 34 F.4th 179, 183 (3rd Cir. 2022).

laid upon . . . individuals; (2) imposed by, or under the authority of the legislature; (3) for public purposes; (4) under the police or taxing power of the state; (5); universally applicable to similarly situated entities; and (6) whether granting priority status to the government will disadvantage private creditors with like claims.²³

According to the Third Circuit, all the factors supported the finding that the SRP is a tax.²⁴

First, the payment is an involuntary pecuniary burden upon individuals who fail to maintain minimum health insurance coverage. See 26 U.S.C. § 5000A(b)(1). Second, it was imposed by Congress. See *id.* Third, it was levied for the public purpose of “expand[ing] health insurance coverage.” *Sebelius*, 567 U.S. at 567, 132 S.Ct. 2566. Fourth, it was imposed under Congress's taxing power. *Id.* at 570, 132 S.Ct. 2566. Fifth, it is universally applicable to all taxpayers subject to the Individual Mandate who fail to maintain minimum health insurance coverage. See 26 U.S.C. § 5000A(b)(1). And sixth, granting priority status to the IRS will not disadvantage similarly situated private creditors (since there are none) (internal citations omitted).

²⁵ The court noted that functional analysis required it to consider any relevant factors.²⁶ Here, according to the court, three other factors supported its conclusion.²⁷ First, the shared responsibility payment is not exchanged for a government benefit.²⁸ Second, the payment is calculated and administered like a tax.²⁹ Third, the payment lacks typical penal characteristics.³⁰ Thus, according to the Third Circuit, the SRP is a tax for purposes of the Bankruptcy Code.

Similarly, the United States Court of Appeals for the Fourth Circuit held that the SRP is a tax.³¹ According to the Fourth Circuit, when determining if an exaction is a tax the “proper analysis is to arrive at the real nature of the [exaction] is to examine all the facts and

²³ *Id.* at 185 (citing *In re United Healthcare Sys. Inc.*, 396 F.3d 247, 253 (3d Cir. 2005)).

²⁴ *Id.* at 187.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ See *United States v. Alicea*, 58 F.4th 155, 164 (4th Cir. 2023).

circumstances and assess them on the basis of economic realities.”³² The Fourth Circuit relied on the following four factors, which are similar to those the Third Circuit relied on: (1) an involuntary pecuniary burden . . . laid upon individuals (2) imposed by, or under authority of the legislature; (3) for public purposes, including the purpose of defraying expenses of government of undertakings authorized by it; and (4) under the police or taxing power of the state.³³ The court found that four factors and the functional analysis led them to conclude that the SRP is a tax.³⁴ Additionally, the court noted that the government imposes the SRP under its taxing power, raising some revenue, which is an essential tax feature.³⁵

II. SRP Eligibility to be Entitled to Priority under the Bankruptcy Code.

A. Certain Taxes are Entitled to Priority Under the Bankruptcy code.

Section 507 of the Bankruptcy Code prioritizes certain expenses and claims.³⁶ Some courts have found that an SRP may be a priority claim under section 507(a)(8)(A), which provides unsecured claims of governmental units are allowed for a tax on or measured by income. Other courts have found that the SRP may be entitled to priority under section 507(a)(8)(E)(i), which provides priority for an excise tax on a transaction.

i. Courts have held that the SRP is entitled to priority.

The Third and Fourth Circuits have held that the SRP is a tax entitled to priority as a tax measured on income under section 507(a)(8)(A).³⁷ Neither Circuit addressed if the SRP could be entitled to priority as an excise tax. Additionally, a Bankruptcy Appellate Panel for the United

³² *Id.* at 164 (citing *United States v. City of Huntington*, 999 F.2d 71, 73 (4th Cir. 1993)).

³³ *Id.*

³⁴ *Id.* at 164-165.

³⁵ *Id.*

³⁶ 11 U.S.C. § 507.

³⁷ *See In re Szczyporski*, 34 F.4th 179, 190 (3rd Cir. 2022) (the Third Circuit reasoning that the shared responsibility payment is a tax that is measured by income because the amount of the payment is determined by a taxpayer’s household income); *see also United States v. Alicea*, 58 F.4th at 166 (the Fourth Circuit held that “[b]ecause the SRP is a tax that is measured by income, the government’s claim is entitled to priority under 11 U.S.C. §507(a)(8)(A).”).

States Court of Appeals for the Sixth Circuit held that the SRP is a tax measured by income entitled to priority under section 507(a)(8)(A).³⁸

Four lower courts have also held that the SRP may be a tax entitled to priority as either an excise or income tax. The United States Bankruptcy Court for the Eastern District of Louisiana held that the SRP could be an excised tax under 507(a)(8)(E)(i) or a tax on or measured by income under section 507(a)(8)(A).³⁹ The court stated that an excise tax is imposed upon “a particular use of property or upon the exercise of right or privilege.”⁴⁰ The SRP could be an excise tax under 507(a)(8)(E)(i), because it is assessed when an individual exercises their right or privilege to remain uninsured.⁴¹ The court also stated it could be an income tax under section 507(a)(8)(A) because it is based on an individual's income level.⁴² The court stated that the SRP could fit both definitions under the Bankruptcy Code and is entitled to priority.⁴³

In a brief opinion, the United States Bankruptcy Court for the Southern District of Florida agreed with the SRP analysis from *In re Cousins*, stating, “[b]ased upon a review of the relevant case law and the arguments of the parties, the Court agrees with the reasoning as stated in *Matter of Cousins*”⁴⁴ Furthermore, the United States Bankruptcy Court for the Middle District of Georgia held that the SRP is entitled to priority under section 507(a)(8)(A) because the SRP is a tax measured by income.⁴⁵ Lastly, the United States District Court for the District of

³⁸ *In re Juntoff*, 636 B.R. 868, 887-888 (B.A.P. 6th Cir. 2022) (reasoning that the SRP is calculated as a percentage of household income). *In re Juntoff* is not binding on the Sixth Circuit, it is only persuasive authority.

³⁹ *In re Cousins*, 601 B.R. 609, 621 (Bankr. E.D. La. 2019)

⁴⁰ *Id.* at 620.

⁴¹ *Id.*

⁴² *Id.* at 621

⁴³ *Id.* at 621.

⁴⁴ *In re Gabbidori*, Case No. 19-13125-BKC-PGH, 2020 WL 3566538, at *1 (Bankr. S.D. Fla. June 4, 2020).

⁴⁵ *In re Miller* 634 B.R. 641, 645 (Bankr. M.D. Ga. 2021) (stating the calculation of a taxpayer's SRP is either a flat fee or a percentage of an individual's income).

Arizona held that the SRP is a tax on or measured by income and is entitled to priority under section 507(a)(8)(A).⁴⁶

ii. Courts have held the SRP is not entitled to priority.

Certain courts have held that the SRP is not entitled to priority because it is not an excise tax on a transaction or a tax on or measured by income as defined in section 507 of the Bankruptcy Code. The SRP's priority has been heavily litigated, and there is no established rule.

The Fifth Circuit held the SRP is not entitled to priority as an excise tax under section 507(a)(8)(E)(i).⁴⁷ The court reasoned that an excise tax is imposed on "some type" of activity, and the SRP does not require activity but is imposed when there is inactivity.⁴⁸ *In re Chesteen*, however, does not overrule *In re Cousins* because the Fifth Circuit did not address whether the SRP is entitled to priority as a tax on or measured by income under section 507(a)(8)(A).

The United States District Court for the Eastern District of Wisconsin held that the SRP is not entitled to priority as an excise tax on a transaction under section 507(a)(8)(E)(i) because there is no affirmative action an individual must take to owe the SRP.⁴⁹ The court noted it is an individual's inaction to maintain a certain level of health insurance that makes the SRP become due.⁵⁰

The United States Bankruptcy Court for the District of Montana held that the SRP is an excise tax but not a tax on a transaction and is thus not entitled to priority under section 507(a)(8)(E)(i).⁵¹ The United States Bankruptcy Court for the Eastern District of North Carolina held

⁴⁶ U.S. v. Brown, Case. No. Cv-21-02092-PHX-DWL, 2023 WL 2237322 (D. AZ. January 5, 2023) (agreeing with the Circuit courts in *In re Szczyporski* and *United States v. Alicea*).

⁴⁷ See *In re Chesteen*, 799 Fed. Appx. 236, 240 (5th Cir. 2020).

⁴⁸ *Id.*

⁴⁹ *IRS v. Huenerberg*, 623 B.R. 841, 845-47 (E.D. Wis. 2020).

⁵⁰ *Id.*

⁵¹ *In re Jones*, 610 B.R. 663, 669 (Bankr. D. Mont. 2019) (reasoning that the SRP is not imposed in a transaction as required by the Bankruptcy Code).

the SRP is not entitled to priority as an excise tax under section 507 (a)(8)(E)(i).⁵² The court agreed with the Fifth Circuits' conclusion in *In re Chesteen* that the SRP is not an excise tax on a transaction because it is assessed to individuals who do not engage in any activity.⁵³ The court did not address whether the SRP is entitled to priority under section 507(a)(8)(A).

Conclusion

The Supreme Court has held that the SRP is a tax. Yet, that decision is not applicable in the bankruptcy context. In general, courts utilize the functional analysis for determining whether an exaction is a tax under the Bankruptcy Code. The courts that have addressed the issue have concluded that the SRP is a tax under the Bankruptcy Code. However, the courts are divided as to whether the SRP is a tax entitled to priority under the Bankruptcy Code. Those that have refused to confer priority on the SRP have generally done so because they have concluded that the SRP is a penalty and not a tax, which would not be entitled to priority.

⁵² *In re Albracht*, 617 B.R. 851, 855 (Bankr. E.D.N.C. 2020).

⁵³ *Id.*