Legislative Recommendation #58

Amend IRC § 36B(d)(2) to Prevent Individuals From Losing Some or All of Their Premium Tax Credits When Receiving Lump-Sum Social Security Benefits Attributable to a Prior Year

PRESENT LAW

IRC § 36B, enacted as part of the Patient Protection and Affordable Care Act, provides a tax credit to certain taxpayers to help them purchase health insurance through a Health Insurance Marketplace (*i.e.,* the Exchange).[1] This "premium tax credit" (PTC) is only available to taxpayers with household incomes between 100 percent and 400 percent of the Federal Poverty Level.[2] It does not make any accommodation for taxpayers who receive a one-time lump-sum payment.

Eligible taxpayers can choose to receive advance payments of the PTC (referred to as APTC) in monthly amounts paid directly to the taxpayer's insurance provider. The amount of APTC for which a taxpayer is eligible is based in part on the taxpayer's anticipated household income for the year.[3] The taxpayer must "reconcile" the APTC paid on his or her behalf with the amount of PTC for which the taxpayer is ultimately eligible on his or her tax return.[4] If the APTC the taxpayer received exceeded the PTC that should have been allowed, the taxpayer generally will incur a tax liability.[5] If a taxpayer's household income, as defined by IRC § 36B(d)(2)(A), exceeds 400 percent of the Federal Poverty Level, the taxpayer must repay the full APTC.

Taxpayers applying for Social Security benefits may not receive a determination from the Social Security Administration (SSA) for one or more years. Consequently, the SSA may issue a substantial lump-sum award retroactive to the date the application was filed. A portion of these benefits may be taxable. To compute the taxable income portion of the lump-sum award (outside the context of the PTC), a taxpayer has the option of (i) calculating the taxable amount of the lump-sum payment using the general rules of IRC § 86, which base the taxability of Social Security payments on the taxpayer's income for the year of receipt of the payment, or (ii) making an election under IRC § 86(e) to calculate the taxable portion of a lump-sum payment in a manner that allocates the payment over the period of years the payment covers.

However, IRC § 36B(d)(2)(B) does not allocate a multiyear lump-sum payment when computing modified adjusted gross income (MAGI) for PTC purposes. It requires the inclusion of the entirety of the multiyear

---

1 Congress enacted the Patient Protection and Affordable Care Act (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010), to "improve access to and the delivery of health care services for all individuals, particularly low income, underserved, uninsured, minority, health disparity, and rural populations." § 5001, 124 Stat. 588.

2 IRC § 36B(c)(1); Treas. Reg. 1.36B-2(b)(1). The Federal Poverty Level is defined by the Office of Management and Budget and is updated by the Secretary of Health and Human Services.

3 Household income is the sum of the taxpayer's modified adjusted gross income (MAGI) plus the MAGI of family members: (i) for whom the taxpayer is allowed a deduction under IRC § 151 and (ii) who were required to file a federal income tax return under IRC § 1. IRC § 36B(d)(2).

4 IRC § 36B(f).

5 *But cf.*, Treas. Reg. 1.36B-4(a)(3) (providing limitations on the repayment of APTC based on incomes below 400 percent of Federal Poverty Level).

retroactive award in the year of receipt,[6] even if a portion of that award would be excludable from gross income under IRC § 86. This one-time lump sum augments the taxpayer's income for that year only and may push MAGI over 400 percent of the Federal Poverty Level, regardless of whether any portion of the Social Security benefits relates to prior years or whether the benefits constitute taxable income in the year of receipt.

REASONS FOR CHANGE

A taxpayer cannot control the SSA's application review process to plan for the month — or year — in which the SSA will issue the benefit award and potentially impact the APTC helping the taxpayer maintain health insurance. Consequently, the taxpayer's income in the year of the award will be artificially inflated when compared to prior and subsequent years only because of the delay in the benefit award. For example, assume a low-income taxpayer without other income applied for Social Security benefits that would pay her $17,500 a year. If the SSA approved the application immediately, the taxpayer would receive annual benefits of $17,500 and could continue to qualify for the PTC in all years. However, if the SSA approved the application two years later, the taxpayer could receive a lump-sum payment of $52,500 in the third year ($17,500 benefits multiplied by two years of SSA evaluation plus $17,500 in the award year), rendering her ineligible for the PTC in that year and potentially requiring her to increase her tax liability by the amount of APTC already paid on her behalf in that year.[7]

The PTC and APTC are benefits designed for low- and moderate-income individuals to assist with health insurance premium payments. The impact of receiving Social Security benefits in a lump-sum can be so harsh as to not only eliminate this assistance in a given year but also to create a substantial tax liability.[8] Just as IRC § 86(e) gives taxpayers who receive lump-sum Social Security payments covering multiple years the option of computing their income for the year of the lump-sum payment by, in effect, treating the payment as having been received in the years to which the payment relates, the National Taxpayer Advocate recommends giving taxpayers a similar option to determine their MAGI for purposes of determining the amount of PTC for which they are eligible.

RECOMMENDATION

- Add a new subsection to IRC § 36B(d)(2) permitting taxpayers to include in MAGI only the taxable portion of a lump-sum Social Security payment calculated pursuant to IRC § 86(e) to determine the amount of PTC for which they are eligible.

6 TAS Research estimates that more than 283,000 taxpayers were impacted by this lump-sum consequence in tax year 2018, which would have resulted in their disqualification for PTC. TAS Research further estimates that more than 53,000 of these taxpayers would have fallen below the poverty line but for their receipt of the lump-sum Social Security benefit. IRS, Compliance Data Warehouse, Information Returns Master File and Individual Returns Transaction File.

7 This example is based on the 2020 Federal Poverty Level for a single-person household in the 48 contiguous states and Washington, D.C.

8 While this legislative recommendation focuses on the interaction between the PTC/APTC and Social Security benefits, we suggest considering the framework we present here for taxpayers who may experience the same financial impact when receiving other one-time lump-sum payments.