Legislative Recommendation #61

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] For years other than 2021 and 2022,[2] this credit, known as the "premium tax credit" (PTC), is only available to taxpayers with household incomes between 100 percent and 400 percent of the Federal Poverty Level.[3] It does not make any accommodation for taxpayers who receive a one-time lump-sum payment of Social Security benefits.

Eligible taxpayers can choose to have 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.[4] The taxpayer must "reconcile" on his or her tax return the amount of APTC paid on his or her behalf with the amount of PTC that the taxpayer is allowed for the year of coverage.[5] If the APTC paid exceeds the PTC allowed, the taxpayer will incur a tax liability equal to the excess APTC amount, subject to a limitation for taxpayers with household incomes under 400 percent of the Federal Poverty Level.[6] If a taxpayer's household income exceeds 400 percent of the Federal Poverty Level, the taxpayer generally must increase his or her tax liability by the full APTC amount paid on the taxpayer's behalf.

When individuals apply for Social Security disability benefits, they 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 portion of the lump-sum award in the year the SSA makes the payment, the 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 allocate the lump-sum payment over the period of years the payment covers and calculating the taxable portion of the payment based on the taxpayer's income for those years.

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 entire multiyear retroactive

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 Section 9661 of the American Rescue Plan Act of 2021 (ARPA), Pub. L. No. 117-2, 135 Stat. 4, 182-83 (2021), allows taxpayers with household incomes over 400 percent of the Federal Poverty Level to be eligible for a PTC, but only for tax years beginning in 2021 and 2022.

3 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 annually by the Secretary of Health and Human Services. *See*, *e.g.*, 86 Fed. Reg. 7732 (Feb. 1, 2021).

4 Household income is the sum of the taxpayer's modified adjusted gross income (MAGI), the MAGI of the taxpayer's spouse if a joint return is filed, and the MAGI of the taxpayer's dependents required to file a federal income tax return under IRC § 1. *See* IRC § 36B(d)(2).

5 IRC § 36B(f).

6 *But cf.*, section 9662 of the ARPA, which suspends the requirement to increase tax liability for excess APTC for tax years beginning in 2020. Pub. L. No. 117-2, 135 Stat. 4, 183 (2021).

award in the year of receipt,[7] even if a portion of that award would be excludable from gross income under IRC § 86. This one-time lump-sum payment increases the taxpayer's MAGI for that year only and may push household income 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 are includible in 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 household income in the year of the award will be artificially inflated when compared to prior and subsequent years due to 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), which would result in household income over 400 percent of the Federal Poverty Level, thus 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.[8]

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 the value of this assistance in a given year but also to create a substantial tax liability.[9] 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 adjusting the calculation of MAGI to exclude any portion of a lump-sum Social Security benefits payment attributable to a prior year for purposes of determining the amount of PTC for which they are eligible.

RECOMMENDATION

- Amend IRC § 36B(d)(2) to exclude from MAGI any portion of a lump-sum Social Security benefits payment attributable to a prior year pursuant to IRC § 86 for purposes of determining whether a taxpayer is eligible for a PTC and, if eligible, the amount of PTC allowed.[10]

7 TAS Research estimates that nearly 288,000 taxpayers were impacted by this lump-sum consequence in tax year 2019, which would have resulted in their disqualification for PTC. IRS, Compliance Data Warehouse, Information Returns Master File and Individual Returns Transaction File.

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

9 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, such as Railroad Retirement Board (RRB) benefits.

10 For legislative language generally consistent with this recommendation, see Build Back Better Act, H.R. 5376, 117th Cong. § 137303 (as passed by the U.S. House of Representatives, Nov. 19, 2021).