



Weekly Checkup

Loophole Gives Uninsured Way Around ACA Penalties

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In a set of [rules](#) released last week, the IRS finalized Affordable Care Act (ACA) regulations for individuals who fail to comply with the law's individual mandate. Beginning next year, those failing to purchase insurance will pay the greater of a \$95 fine or 1% of their household income. Penalties are slated to reach upwards of \$695 or 2.5% of household income by 2016 and will be adjusted beyond that date. While the penalty is meant to deter the uninsured from violating the mandate, the wording of the rule may encourage creative tax planning to avoid paying penalties.

Unlike other taxes and penalties, the ability of the IRS to enforce and collect the mandate tax is constrained. Under [§ 1501\(g\)\(2\)](#) of the ACA, the agency is precluded from using its traditional means of collecting fines and back-taxes. The law provides that those facing the penalty “shall not be subject to any criminal prosecution or penalty” for nonpayment. Moreover, liens and levies cannot be placed on the property of the uninsured. Therefore, the only means of collection at the IRS’s disposal is the garnishment of the uninsured person’s income tax refund. This narrow window affords intuitive would-be tax-avoiders the opportunity to flout the system.

Preventing tax overpayment in order to reduce or eliminate a tax refund would be an easy tactic to avoid paying the individual mandate’s penalty. For employees subject to regular withholding, the general rule is that claiming fewer W-4 allowances results in more taxes being withheld, resulting in a higher refund. In order to ensure that the taxes remitted from their paycheck are less than or equal to the amount of taxes owed in a given year, uninsured employees can, within reason, increase their number of allowances. Those who are self-employed, and not subject to regular withholding, are required to file [estimated taxes](#) with the IRS on a quarterly basis. With some careful calculations, an uninsured, self-employed person can plan their quarterly payments to ensure that no overpayment occurs.

For those considering the use of these techniques to remain uninsured and avoid penalties, there is a caveat: the penalty does not simply disappear in the absence of a tax refund. Under [§ 6601](#) of the IRS Code, unpaid penalties are carried over to subsequent filing years and collect interest at a rate of [at least 3%](#) until they are paid. Regardless of the size of the mounting penalties and interest, the IRS is bound by the rules of the ACA and as such, is still limited in its ability to collect these delinquent fines.

The existence of this loophole, combined with the IRS’s restricted collection options, will limit the effectiveness of the penalty. The uninsured face little in the way of consequences for failing to adhere to the individual mandate. With the success of the ACA contingent upon mass enrollment of the uninsured, particularly those who are healthy and don’t foresee needing that insurance, this loophole may prove troublesome.