Gambling for Health Care

JACK L. MILLMAN*

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I. INTRODUCTION

Gamble. Win a little. Maybe lose a little more. Obtain free health insurance? It is an absurd tax planning technique that should actually work—at least in theory. And, it perfectly illustrates the nonsensical system now in place in the states that have refused to expand Medicaid coverage as envisioned when the Affordable Care Act was enacted. In those states, the very poor tend to be already covered by Medicaid, while those with higher incomes qualify for the exchange-based credits. A middle group—those too poor to be covered by the Affordable Care Act but not impoverished enough to qualify for their state's Medicaid coverage—is left out in the cold. Oddly, gambling may provide this group a way to obtain subsidized health care coverage.

In this Paper I argue that certain low income taxpayers could prepare to gamble in the upcoming year in order to inflate their estimated Adjusted Gross Income (AGI) and qualify for thousands in health insurance related tax credits—thus making their insurance affordable. Tax planning strategies usually do not involve *increasing* one's AGI via gambling, but states' refusal to expand Medicaid, combined with the Affordable Care Act, has created a situation where millions of adults' best opportunity to obtain health insurance may come through gambling. I do not advocate that most eligible taxpayers should actually attempt this strategy for reasons detailed below, but instead discuss it to illustrate the current problems with the law.

One possible objection to this strategy is the downside economic risk these already poor Americans would have to bear in order to get the health insurance subsidy. Another possible objection concerns the risk that the IRS may disallow attempts to avoid the economic downside anyway, resulting in the

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poor getting stuck with losses twice. Others may have moral objections. They might argue that it violates the spirit of the Affordable Care Act. I would respond that taxpayers are simply following the (nonsensical) laws currently on the books that theoretically tried to expand health care coverage to the lower and middle classes. All of this just goes to illustrate the perversity of the current situation and the need for Congress or states to act.

II. BACKGROUND TO THE PROBLEM

The problem begins with provisions in the Affordable Care Act that limit which taxpayers qualify for tax credits that subsidize health insurance.[1] In order to obtain the advance tax credit, U.S. citizens have to purchase health insurance from a state exchange or the federal exchange[2] and estimate that their household income will be between 100% and 400% of the federal poverty level (FPL) for the upcoming year.[3] They also have to predict that they will not be eligible for Medicaid or another form of government-sponsored minimum essential coverage in the upcoming year.[4]

Taxpayers can elect to have the tax credit paid directly to the health insurance provider each month, ensuring that the taxpayer's monthly premium remains affordable—hence why it is known as an "advance tax credit." When taxpayers file their tax return in the following year, they must complete a reconciliation form using their real income from the preceding year if they elected to receive an advance tax credit. If their income has changed from what they estimated, they may receive a larger or smaller tax credit than what they actually received throughout the preceding year, which would result in a larger or smaller tax burden, depending on other factors. The amount a taxpayer has to pay back is capped based on his or her income. For example, an individual who ended up earning less than 200% of the FPL would have to pay back a maximum of $300 (for an individual) or $600 (for a household) in

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[1] Patient Protection and Affordable Care Act of 2010 § 1401, I.R.C. § 36B (2012); *see also* 26 C.F.R. § 1.36B–2 (2014) (discussing which taxpayers are allowed a premium tax credit).

[2] Whether or not taxpayers can receive the advance tax credit if they purchase their health insurance from a federal exchange because their state declined to set up an exchange is currently being litigated. King v. Burwell, 759 F.3d 358, 373 (4th Cir. 2014) (upholding IRS regulations allowing those getting health coverage from the federal exchange to receive advance tax credits), *cert. granted*, 135 S. Ct. 475 (2014); Halbig v. Burwell, No. 14-5018, 2014 U.S. App. LEXIS 17099, at *5–6 (D.C. Cir. Sept. 4, 2014) (vacating a D.C. Circuit's panel decision that held taxpayers cannot receive the advance tax credit if they purchase their health insurance from a federal exchange).

[3] 26 C.F.R. § 1.36B–2(b)(6)(ii).

[4] 26 C.F.R. § 1.36B–2(a)(2) (stating that an individual who is eligible for minimum essential coverage outside the exchange cannot get a tax credit); 26 C.F.R. § 1.36B–2(c)(2) (defining government-sponsored minimum essential coverage).

received advance tax credits—even if he or she were no longer eligible for any health care credits.[5]

So far, so good—except the drafters of the Affordable Care Act assumed that Medicaid would quickly be expanded in every state. This expansion would have resulted in almost every U.S. citizen in a household with an income at or below 138% of the FPL qualifying for Medicaid. Those individuals in households with incomes above 138% of the FPL would either qualify for the tax credits or presumably be wealthy enough to afford health insurance without a subsidy. Instead, many states have chosen not to expand Medicaid after the Supreme Court ruled in *National Federation of Independent Business v. Sebelius* that the federal government could not coerce the states into the expansion.[6] Some of these states, such as Texas, have very stringent Medicaid eligibility for adults; even those adults with household incomes under 100% of the FPL often cannot qualify for Medicaid.[7]

Hence five million adults are predicted to fall into a "gap" between subsidies and Medicaid.[8] This population is composed of very poor individuals who are too old to qualify for health care under the Children's Health Insurance Program, live in a household in which the income is under 100% of the FPL, and reside in a state in which they are not otherwise eligible for Medicaid or another form of government-provided minimal essential coverage.

III. ONE ABSURD SOLUTION TO AVOID THE "GAP"

For these unfortunate taxpayers, planning a trip to the casino to get out of the "gap" may be in order. If "[a]n Exchange estimates at the time of enrollment that the taxpayer's household income will be between 100 and 400 percent of the Federal poverty line for the taxable year," the taxpayer can qualify for the advance tax credit and obtain subsidized insurance through the exchange, even if his income ends up being under 100% of the FPL for that

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[5] I.R.C. § 36B(f)(2)(B)(i). This would occur if a taxpayer earned less than 100% of the FPL and no longer qualified for any tax credit. *See supra* note 3 and accompanying text.

[6] *See* Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2662, 2666 (2012) (finding the Medicaid expansion to be unquestionably coercive, and thus unconstitutional, for the burden placed on states that refuse). "A total of 27 states, including DC, are currently implementing the ACA Medicaid expansion in 2014." THE KAISER COMM'N ON MEDICAID AND THE UNINSURED, THE HENRY J. KAISER FAMILY FOUNDATION, WHERE ARE STATES TODAY? MEDICAID AND CHIP ELIGIBILITY LEVELS FOR CHILDREN AND NON-DISABLED ADULTS AS OF APRIL 1, 2014 (June 11, 2014), *available at* http://kff.org/medicaid/fact-sheet/where-are-states-today-medicaid-and-chip/, *archived at* http://perma.cc/TGS5-LXX7 (noting that three other states plan on implementing the Medicaid expansion plans later in 2014 or post 2014).

[7] *Id.* (showing the Medicaid eligibility breakdown in Figures 3 and 4).

[8] *Id.*

year.[9] The advance tax credit is based on a taxpayer's modified adjusted gross income (MAGI), calculated as AGI plus a few other items not relevant to this Article.[10] The important thing is that gambling income is taken into account when estimating one's income,[11] and can increase one's MAGI.[12]

Gambling works as a tax planning technique because of how it affects AGI. If a taxpayer has $3,000 in gambling winnings and $3,500 in gambling losses in a given year, he is not allowed to net it out. Instead, per the law and IRS regulations, he would have to report the $3,000 as above the line income that increases his AGI, and then can take up to $3,000 as an itemized deduction.[13] Additionally, one cannot deduct more gambling losses than he has gambling winnings.[14] Normally this penalizes taxpayers who gamble. Now, it incentivizes some taxpayers to plan on gambling to claim a higher expected MAGI, even if they are predicted to lose money. The gambling losses would be offset by the health care credits—resulting in a financial gain.

For example, imagine Julia, an unmarried mother with two children living in Texas. The children are covered by government health insurance, but she is not. In 2013, she earned $18,000 from working a total of forty hours a week at two $9 per hour part-time jobs. Her employers do not offer health care coverage. She expects to earn the same amount in 2014, which would be 90.96% of the 2014 FPL of $19,790 for a three person household. However, if she expects to have $1,790 in gambling winnings and $2,000 in gambling losses from hitting the slots, she would qualify for the advance tax credit.[15] Despite losing $210 gambling, she would receive a tax credit worth up to $2,868.[16] However, Julia would also receive $377 less from the Earned

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[9] 26 C.F.R. § 1.36B–2(b)(6)(ii).

[10] I.R.C. § 36B(d)(2)(B).

[11] *Reporting Income and Household Size: What's Included as Income*, HEALTHCARE.GOV, https://www.healthcare.gov/income-and-household-information/income/, *archived at* https://perma.cc/C2FH-EU2Q.

[12] Any gambling wins are reported as income above the line per I.R.C. § 61(a). Yet, gambling losses can only be taken as itemized deductions, and the deduction cannot be greater than the amount of winnings. I.R.C. § 165(d). Normally this disfavors the taxpayer—those taking the standard deduction cannot offset their winnings, and increasing one's AGI often leads to a reduction in certain tax credits.

[13] I.R.C. § 61(a) (defining gross income broadly); I.R.C. § 165(d) (regarding gambling losses).

[14] *Id.*

[15] Taxpayers could always just lie about their estimated income, always fall short, and then pay the $300 or $600 reconciliation tax and repeat the process. However, this would presumably lead to income verification screening being tightened in response to reports of fraud and abuse, as well as possible civil and criminal penalties for lying on a tax return document. Gambling on the other hand is perfectly legitimate.

[16] I gathered this information by entering zip code 75001 into the Kaiser Family Foundation Health Insurance Marketplace Calculator. *See Health Insurance Marketplace Calculator*, THE HENRY J. KAISER FAMILY FOUNDATION, http://kff.org/interactive/subsidy-calculator/#state=tx&zip=75001&income-type=dollars&income=20000&employer-coverage=0&people=3&alternate-plan-family=individual&adult-

Income Tax Credit (EITC).[17] Overall, she would theoretically be $2,281 better off.[18]

While the Affordable Care Act presumably did not intend to encourage poor taxpayers to gamble, that does not mean this strategy violates the spirit of the law. After all, without *Sebelius* affecting the Medicaid expansion, those five million adults would have been covered through Medicaid.[19] The purpose of the law was to expand health care coverage to include those less well-off;[20] instead the law now excludes millions of those below the FPL. I am skeptical that anyone who voted in favor of the Affordable Care Act intended to exclude these taxpayers.

IV. PRACTICAL CONSIDERATIONS AND POLICY CONCERNS

One might argue that this situation is not nonsensical, but actually creates an incentive to work, as taxpayers could honestly estimate their income will be higher because of a new job or an increase in hours. Much of this comes down to how the "estimates" are allowed to be calculated and how aggressively they are policed. If taxpayers have made an honest effort to increase their income but failed in the preceding year, could they try again? What "honest effort" standard should be created, and how would it be administered?[21] Could

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count=1&adults%5B0%5D%5Bage%5D=40&adults%5B0%5D%5Btobacco%5D=0&child-count=0&child-tobacco=0, *archived at* http://perma.cc/Y4PM-QK3W.

[17] Julia would be $2,170 over the EITC phase-out number of $17,830, $1,790 of which would be a result of the gambling—this would result in a reduced refund. *Taxation and the Family: What Is the Earned Income Tax Credit?*, TAX POLICY CENTER, http://www.taxpolicycenter.org/briefing-book/key-elements/family/eitc.cfm, *archived at* http://perma.cc/4XGJ-FNAX (describing 2014 Earned Income Tax Credit parameters).

[18] She may prefer the $587 in cash to the $2,868 worth of health care subsidies and would not be better off in regards to personal utility. However, after the calculation is made a taxpayer could always decline to pursue the strategy if the cash is worth more to them.

[19] *See supra* note 6 and accompanying text (discussing the impact of the Supreme Court's decision).

[20] Albeit in a horribly complex and rather inefficient way.

[21] The IRS could greatly mitigate this problem by adopting a very loose standard of "reasonable estimate" for those taxpayers estimating their income to increase to above 100% of the FPL in the upcoming year. This action would be controversial and possibly backfire for several reasons. Many opponents of the Affordable Care Act already believe the executive branch continually twists the statute beyond recognition to accomplish political goals. *See* Deirdre Walsh, *GOP-led House Authorizes Lawsuit Against Obama*, CNN (July 31, 2014, 8:04 AM), http://www.cnn.com/2014/07/30/politics/gop-obama-lawsuit/, *archived at* http://perma.cc/BY7B-N93M (discussing how the House authorized a lawsuit to sue President Obama and accusing him of abusing his power relating to certain executive actions regarding the Affordable Care Act). A very loose standard would create a high potential for fraudulent behavior, which could undermine support for an already unpopular law. Finally, it could lead to a very strict standard eventually being adopted to deal with the outcry.

taxpayers use the gambling estimate as a fail-safe in case they cannot otherwise increase their income?[22]

This situation cannot be fairly analogized to the Earned Income Tax Credit's explicit mission of encouraging work. The EITC differs because it explicitly ties an increase in the credit to earnings from work.[23] While one has an incentive to artificially inflate their earned income by creating fictitious income, they can only legitimately increase their financial gain by working more. Gambling can only not affect or decrease the amount of money a taxpayer receives from the EITC, which is consistent with a tax code that generally treats gambling unfavorably.[24] In fact, the EITC's negative treatment of gambling directly conflicts with the Affordable Care Act's positive treatment of gambling; this is why taxpayers who pursue this strategy will often lose a portion of their EITC.[25] Additionally, the EITC does not rely on estimates, but actual earnings, eliminating the accuracy problems associated with forecasting future income.

A gambling tax-planning strategy would probably not be a realistic option for most taxpayers in the "gap." For some taxpayers, especially those earning just below 100% of the FPL, the benefits would significantly outweigh the costs to the point that it may actually become a legitimate option.[26] For many others, it probably is not. This is because increased taxes may offset the amount of the credit and render the subsidies undesirable. Some taxpayers may have a religious or moral belief that precludes them from gambling. This strategy also results in a waste of time and resources, as spending time gambling to inflate one's income is not economically productive. Of course, the same can be said of almost any tax planning strategy that involves transactions with little real economic purpose yielding large tax benefits.

In order to use this strategy, there has to be some defined way to properly estimate gambling winnings and losses. A few examples demonstrate how the same planned gambling acts can be interpreted in very different ways when it comes to their impact on one's income. Imagine there is one kind of bet: $50 on a coin flip. If you estimate you are going to make ten bets on ten different days, your expected winnings would be $250 and your expected losses would

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[22] If a taxpayer is not allowed to say, "I plan on getting a job and increasing my income to above 100% of the FPL" and get the tax credit, could they say, "I plan on getting a job or gambling to ensure my income is above 100% of the FPL?"

[23] I.R.C. § 32(a)(1) ("[T]here shall be allowed as a credit . . . an amount equal to the credit percentage of so much of the taxpayer's *earned income* for the taxable year as does not exceed the earned income amount.") (emphasis added).

[24] *See, e.g.*, I.R.C. § 165(d) (allowing wagering losses to be deducted only to the extent of wagering gains).

[25] *See supra* Part III.

[26] The closer taxpayers are to 100% of the FPL, the less they have to gamble to qualify for the tax credit. Their expected gambling loss will be lower. They will also suffer a smaller reduction in the EITC, because their income will increase by a smaller amount (assuming their gambling results equal their gambling estimates).

be $250. However, gambling winnings and losses are calculated by session.[27] If someone sits down and plays ten rounds of coinflip betting (or blackjack), wins five, and loses five, he would not report winnings of $250 and losses of $250. He would have one session that resulted in $0 of income. Things change yet again if you estimate that you will play five sessions of coin-flip betting, and plan on placing two bets in each session. The expected value of each session is still $0. Yet, the odds of a gambler having at least one winning session of $100 are 76.3%. That is because the odds of each session being a winning one are 25%, and over five sessions that means the odds are 76.3% (1-(.25^5)) that one is a winning session. Should one use expected value, or the more likely outcome of winning at least one session?

Besides the issues discussed above, another problem with gambling is that many qualifying taxpayers either do not have the money to gamble or do not want to risk catching the downside of variance and incurring significant short-term or overall losses. One solution may be a non-profit stepping in. Imagine the non-profit creates a website called "healthcaregambling.com" which had one game–online lottery tickets[28]—and one bet, $1. It sets the odds in such a way that the average return on a $1 bet is 99.9 cents—or a house advantage of 0.1%. This could be done by having two outcomes for each ticket (a loss or doubling one's money) and having slightly more losing tickets than winning.[29] If someone needed $2,000 in winnings to hit their target, this person could deposit $5 and receive a $4,000 loan, buy 4,005 tickets, and then expect to have winnings and losses of slightly more than $2,000 each—with about $4 more of losses. This individual could then cash out the remaining dollar after repaying the loan.

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[27] Shollenberger v. Comm'r, 98 T.C.M. 667, 668 (2009) ("For example, a casual gambler who enters a casino with $100 and redeems his or her tokens for $300 after playing the slot machines has a wagering gain of $200 . . . . This is true even though the taxpayer may have had $1,000 in winning spins and $700 in losing spins during the course of play." (quoting IRS Chief Counsel Advice 2008-011 (Dec. 5, 2008))).

[28] The reason lottery tickets work so well is that they avoid the session problem discussed earlier. Winnings and losses can be traced to individual tickets, so there should be no need to track per session. *Cf. id.* at 667–68. (arguing that no accession to wealth occurred until the chips were converted into cash in the case of a table game). This would cut down on the amount of gambling that needs to be done and limit variance.

[29] If the house has an advantage of 0.1%, this would translate to 1001 losing tickets for every 999 winning tickets. Hence, a person who purchased $2,000 worth of tickets would expect to win $999 dollars from the 999 winning tickets and lose $1,001 from the 1,001 losing tickets, for a net loss of $2, or 0.1% of their "bet." The person has essentially flipped a slightly weighted coin 2,000 times. If one is worried about variance costing this person too much money if they are unlucky, the bet could be reduced to $0.01 while everything else is kept the same. Now the person is flipping a coin 200,000 times, and the odds of losing more than a few dollars in each direction are infinitesimally small. *See Week 9: Tossing a Coin and the Bell Curve*, THE PI-CUBED PROGRAMMING CHALLENGE, http://pi3.sites.sheffield. ac.uk/tutorials/week-9#TOC-More-trials-and-more-tosses (last visited Nov. 6, 2014), *archived at* http://perma.cc/PZ6U-4HHP (explaining the math).

Schemes like the one above may not qualify as true gambling under the tax code because of a lack of significant downside risk.[30] It could run afoul of I.R.C. § 7701(o), which attacks transactions deemed as not possessing "economic substance." Taxpayers who lose this argument risk penalties under I.R.C. § 6662.[31]

V. CONCLUSION

Taxpayers projecting to earn less than 100% of the FPL in the upcoming year who want subsidized health care are in an odd position. To obtain health care, the government is encouraging them to inflate their income estimate by any means necessary. Depending on how stringent estimation standards are, and how strictly they are enforced, many taxpayers could find it much easier to support an assertion of future gambling over an assertion of a future increase in earned income. Yet, in going with the sure thing (gambling) they incur the risk of either downside variance in gambling or the IRS disallowing any "risk-free" gambling scheme. Poor taxpayers are thus stuck with an absurd result, in that not only will they be gambling for their health insurance, but some may be stuck with nothing but losses. Most of these taxpayers will not actually try to gamble their way into qualifying for subsidized health care for the reasons listed above. Instead, they can only hope that Congress, the states, or even the IRS acts.

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[30] A taxpayer could argue that commercial casinos often have a similarly small house advantage, and the IRS presumably would not exclude gambling income won at these establishments. Steve Bourie, *Casinos You Can Bet on: Where the Odds Are Better for You*, BOTTOM LINE PERSONAL (Dec. 15, 2011), http://www.bottomlinepublications.com/content/article/travel-a-recreation/casinos-you-can-bet-on, *archived at* http://perma.cc/LJ8L-HFW6 (describing casinos that have games in which the house advantage is 0.1% and 0.2%).

[31] Under I.R.C. § 6662(b)(6) any disallowance of a tax benefit because the transaction lacks economic substance (as defined in I.R.C. § 7701(o)) results in a penalty of 20% if disclosed, or 40% if not disclosed. Normally this provision deals with questionable transactions done by very wealthy individuals or business entities, but now the poor would get to test its limits as well.