No. 12-1408

In The Supreme Court of the United States

UNITED STATES OF AMERICA,

Petitioner,

v.

QUALITY STORES, INC., ET AL.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF AMERICAN PAYROLL ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

ALLYSON N. HO
Counsel of Record
MORGAN, LEWIS & BOCKIUS LLP
1717 Main Street, Suite 3200
Dallas, Texas 75201
T. 214.466.4000
aho@morganlewis.com

DAVID R. FULLER
MARY B. HEVENER
MORGAN, LEWIS & BOCKIUS LLP
1111 Pennsylvania Avenue, N.W.
Washington, DC 20004
T. 202.739.3000

Counsel for Amicus Curiae American Payroll Association

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

QUESTION PRESENTED

Whether downsizing payments made to involuntarily terminated employees are "wages" subject to Federal Insurance Contributions Act (FICA) taxes.

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INTEREST OF *AMICUS CURIAE*[1]

The American Payroll Association (APA) is the Nation's leading private-sector advocate for payroll issues. A nonprofit association, the APA represents 21,000 payroll professionals who perform payroll processing services for over 17,000 employers, and for the major payroll service providers in the United States who in turn process payrolls for an additional 1.5 million employers.

As payroll specialists, the APA's members determine proper employment tax withholding; prepare and file accurate information returns and statements; correct (when necessary) those returns and statements; calculate and deposit taxes; and maintain payroll records.

The APA thus has a significant interest in the outcome of this case because many of its members process downsizing payments like the ones at issue here that constitute supplemental unemployment compensation benefits under the Internal Revenue Code of 1986, as amended, 26 U.S.C. § 1 *et seq.* (the Code). An easily administrable rule is crucial in this context—and as this Court recognized in *Rowan Cos.*

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[1] Pursuant to Rule 37.6, the *amicus* submitting this brief and their counsel hereby represent that neither the parties in this case nor their counsel authored this brief in whole or in part, and that no person other than *amicus* paid for or made a monetary contribution toward the preparation or submission of this brief. *Amicus* file this brief with written consent from all parties, copies of which are on file in the Clerk's Office.

v. *United States*, 452 U.S. 247 (1981), Congress's intention to have "wages" carry the same meaning for purposes of both the Federal Insurance Contributions Act (FICA) and federal income-tax withholding (FITW) promotes "simplicity and ease of administration." *Id.* at 257.

Accepting the government's contrary argument here would create a great deal of confusion for APA members in that doing so would result in an administrative quagmire for multi-state employers which would end up with different federal payroll rules in different jurisdictions. Furthermore, if taken to its logical conclusion, the government's position that all downsizing payments should be deemed "wages" would have the far-reaching consequence of disqualifying unemployed workers from receiving state unemployment benefits—because those benefits are contingent on the downsizing payments not being "wages." Because the text, structure, purpose, and history of the pertinent statutes and regulations does not permit—much less require—such an untoward result, the decision below should be affirmed.

INTRODUCTION AND SUMMARY OF ARGUMENT

The court of appeals correctly held that, when an employer undergoes downsizing, payments made to terminated employees constitute supplemental unemployment compensation benefits or "SUB

payments." And as defined by Congress in the Code, SUB payments are not taxable as "wages" under FICA. That construction is consistent with the statutory language, the pertinent regulations, and the relevant legislative history. It is consistent with this Court's instruction in *Rowan* that, given the similarity in the statutory definitions, the term "wages" should be construed the same way for purposes of both FICA and FITW.[2] And it is consistent with this Court's teaching in *Coffy* v. *Republic Steel Corp.*, 447 U.S. 191, 200 (1980), that SUB payments are not wages because they fall outside the statutory meaning of "service" performed by an employee for an employer—by definition, an employee is not eligible for SUB payments until service to the employer has ended.

The issue before the Court is how SUB payments should be defined. For decades, Congress, the Treasury Department, the IRS, and the courts uniformly adopted the definition of "supplemental unemployment compensation benefits" that Congress set forth in §§ 3402(o)(2)(A) & 501(c)(17)(D) of the Tax Code as benefits "which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions." These benefits were not treated as

[2] The definition would necessarily be the same for purposes of the Federal Unemployment Tax Act (FUTA).

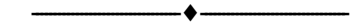
wages for FICA purposes. Now, the government urges that "for FICA and FUTA purposes," SUB payments should be defined "solely through a series of administrative pronouncements" by the IRS that, among other things, depart from the IRS's own longstanding position that the receipt of state unemployment benefits is immaterial to the analysis, and instead requires some sort of (undefined and unexplained) connection between SUB payments and the actual receipt of unemployment benefits. Rev. Rul. 90-72, 1990-2 C.B. 211.

But none of those administrative pronouncements has the force of law, and none addresses the pertinent Treasury Department regulations that have never defined SUB payments in the way urged by the government. Simply put, the inconsistent IRS rulings cannot overcome the plain language of the statute, the governing Treasury Department regulations, the IRS's own contemporaneous publications and forms, or this Court's decisions in *Coffy* and *Rowan*.

The government's position, if accepted, would thus replace the straightforward definition provided by Congress with a cumbersome and essentially unadministrable definition. Among other things, it would require that the payments must be "designed to *supplement* the receipt of state unemployment compensation," Rev. Rul. 90-72 (emphasis added), but provides no guidance as to even the most basic state unemployment elements such as the applicable waiting periods, registration requirements, the impact of part-time employment, or the amount of

permissible SUB payments. Forcing employers to deal with multiple state unemployment regimes to determine federal payroll tax obligations imposes a heavy administrative burden on even the most sophisticated multi-state employers.

In sum, the construction urged by the government in this case is not only contrary to statutory text, congressional purpose, and governing regulations, but also manufactures a definition of "wages" that is imprecise, speculative, varies state by state, and, as a practical matter, injects considerable confusion and uncertainty into the administration of payrolls. That construction should be rejected and the decision below affirmed.



ARGUMENT

I. SUB Payments Are Not Remuneration For "Service" And So Are Not Wages Subject To FICA

We begin, as we must, with the plain language of the statute and construe it according to its plain and ordinary meaning. *Hardt* v. *Reliance Standard Life Ins. Co.*, 560 U.S. 242, 251 (2010). FICA taxes are imposed on "wages," which include "all remuneration for employment" performed by employees for their employers. 26 U.S.C. § 3121(a). "Employment," in turn, is defined as "any *service*, of whatever nature." 26 U.S.C. § 3121(b) (emphasis added). Although the government is correct that the term "wages" is construed broadly for FICA purposes, *Soc. Sec. Bd.* v.

Nierotko, 327 U.S. 358, 365-66 & n.17 (1946), the term is not unlimited.

SUB payments are not wages because they are not remuneration for past, present, or future service. They are just the opposite, as this Court recognized in *Coffy*, because they are "contingent on the employee's being thrown out of work; unless the employee is laid off he will never receive SUB payments * * * they are 'compensation for loss of jobs'" rather than "compensation for work performed." 447 U.S. at 200 (quoting *Accardi* v. *Pa. R.R. Co.*, 383 U.S. 225, 230 (1966)). That is why the government was correct previously in arguing that SUB payments and wages are "mutually exclusive" for payroll tax purposes—a position diametrically opposed to that taken by the government here. Compare *NYSA-ILA Container Royalty Fund* v. *Comm'r*, 847 F.2d 50, 53 (2d Cir. 1988), with Br. 19.

That construction only makes sense given the purpose of SUB payments. Employers make SUB payments only when a worker is *prevented* from performing services as a direct result of downsizing, reductions in force, or layoffs. SUB payments thus do not provide remuneration for service. Instead, as the IRS itself has recognized in the past, they help "promote the welfare of employees laid off." Rev. Rul. 60-330, 1960-2 C.B. 46. SUB payments do that by bridging the gap between periods of employment—a gap that employers and the government both

understand can involve financial hardships on laid-off workers.[3]

Consistent with the understanding of SUB payments articulated by this Court in *Coffy*, Congress, the Treasury Department, and the IRS itself have long recognized SUB payments as a separate and unique category expressly defined for tax purposes: by Congress in the Code; by the Treasury Department in regulations; and by the IRS in rulings, forms, and publications. Linking the payments to job elimination is consistent with this Court's holding in *Coffy* that SUB payments do not constitute "compensation for work performed." 447 U.S. at 200. And under this Court's decision in *Rowan*, the corresponding exclusion from "wages" should be consistently applied for all relevant purposes under FICA, FUTA, and FITW. 452 U.S. at 254.

Now, however, after more than a half century of uniform recognition that SUB payments are a distinct category of payments, the government seeks to lump SUB payments together with all severance and dismissal payments and then argue that SUB payments must be wages unless a statutory exception

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[3] The Congressional Budget Office has analyzed the financial hardships downsized workers face in terms of employment opportunities, earnings potential, health insurance coverage, and unemployment insurance. Molly Dahl & Joyce Manchester, *Losing a Job During a Recession*, CBO Economic & Budget Issue Brief (2010), http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/114xx/doc11429/jobless_brief.pdf.

says they are not. That position, however, cannot be reconciled with this Court's decisions in *Coffy* and *Rowan*, with the plain language of the statute, with the legislative history, with the Treasury Department regulations, or even with some of the IRS's own previous pronouncements and rulings.

Dismissal pay and SUB payments are not synonymous. First, if SUB payments were merely a subset of dismissal pay for FICA purposes (as the government would have it), then it would have been unnecessary for Congress to enact § 3402(o). That section provides for income-tax withholding on SUB payments—an obvious redundancy because dismissal pay is already included under wages and would not need another withholding provision. Second, dismissal pay and SUB pay are treated differently—indeed, as mutually exclusive—by the Treasury Department's FITW regulations. Compare Treas. Reg. § 31.3401(a)-1(b)(4) (2007), with Treas. Reg. § 31.3401(a)-1(b)(14) (2007). And so it also would have been unnecessary for the Treasury Department to issue Treas. Reg. § 31.3401(a)-1(b)(14) because "present law" at the time already included (not excluded) SUB pay as wages.[4]

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[4] Treas. Reg. § 31.3401(a)-1(b)(14)(i) provides: "Supplemental unemployment compensation benefits paid to an individual after December 31, 1970, shall be treated (for purposes of the provisions of Subparts E, F, and G of this part which relate to withholding of income tax) as if they were wages, to the extent such benefits are includible in the gross income of such individual." See also 26 U.S.C. § 419A(f)(1) and Treas. Reg. § 1.419A-1T (1986) (separately defining SUB payments and severance).

II. The Definition Of SUB Payments Set Forth By Congress In The Code Has Been Widely Applied By The Treasury Department, The IRS Itself, And Courts

As explained above, there is no dispute that SUB payments have been excluded from "wages" for FICA purposes for more than half a century. The government cites no authority—and we are aware of none—holding to the contrary. Although the government queries whether the IRS had the authority to exclude *any* SUB payments from FICA, Br. 30, that proposition lacks support. Even the government concedes, as it must, that "Congress effectively acquiesced" in the SUB payments wage exclusion. *Ibid.* The question is how to define SUB payments for purposes of applying the wage exclusion, i.e., whether the term "SUB payments" should be defined by reference to a series of IRS administrative rulings, as the government urges, or by reference to the Tax Code and Treasury Department regulations, as respondent argues (and *amicus* APA agrees).

Although the government (at 21) faults the court of appeals for "misunderstanding[ ]" the "text, history, and purpose" of § 3402(o)—which sets out the statutory definition of SUB payments—and criticizes respondents (at 35) for not offering a "reasonable alternative explanation" of the statute's "origin or purpose" that supports the position that the statutory definition should control, it appears to be the government that has misunderstood the relevant authorities, including its own regulations, rulings, and forms.

A. Congressional And Treasury Department Actions Show That SUB Payments Are Not Subject To FICA

1. Initial Congressional Action

In 1960, Congress enacted § 501(c)(17) to extend tax-exempt status to the trusts used to fund SUB payment benefits. (Although trust funds were initially one of the factors identified by the IRS in its rulings as required for FICA exemption, that factor was soon eliminated from consideration by the IRS in Rev. Rul. 60-330, and has been considered irrelevant ever since.)

Congress was aware that the IRS developed, in revenue rulings, an administrative definition of SUB payments under which the payments "are taxable to the recipients as income (although not generally subject to withholding)."[5] Congress declined, however, to define SUB payments in the same manner as the IRS rulings. Instead, in § 501(c)(17)(D)(i), Congress defined "supplemental unemployment compensation benefits" as:

> [B]enefits which are paid to an employee because of his *involuntary separation from the employment of the employer* (whether or not such separation is temporary) *resulting directly from* a reduction in force, the

[5] S. Rep. 86-1518, *reprinted in* 1960 U.S.C.C.A.N. 3203, 3204.

> discontinuance of a plant or operation, or other similar conditions.

(Emphases added). Under this statutory definition, downsized employees can continue to receive SUB payments even if the employees obtain other employment after they are terminated. That is consistent with the legislative judgment in enacting the Social Security Act of 1935 that "prevention of unemployment is very much more important than compensation for unemployment." 79 Cong. Rec. 9349, 9361 (1935). Congress thus wanted to provide every incentive to encourage reemployment rather than provide any incentive to stay unemployed—and requiring ongoing unemployment as a condition for SUB payments, as the government would have it, could thwart that legislative purpose by acting as a disincentive to timely reenter the workforce.[6]

In the seven years after Congress enacted the statutory definition of SUB payments in § 501(c)(17),

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[6] The House bill would have defined SUB payments as "benefits which are paid to an employee because of his involuntary unemployment (whether or not temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions." S. Rep. 86-1518, *reprinted in* 1960 U.S.C.C.A.N. at 3207. As enacted, however, the phrase "involuntary unemployment" was replaced with the phrase "involuntary separation from the employment of the employer." *Id*. at 3210-11. Similarly, the Treasury Department issued regulations authorizing SUB payments to "an employee who has, subsequent to his separation from the employment of the employer, obtained other part-time, temporary, or permanent employment." Treas. Reg. § 1.501(c)(17)-2(a).

employers expanded SUB payment arrangements to cover more than 2.5 million workers—primarily in the automobile, steel, rubber, and garment industries. Trust funds were initially used "almost without exception" to fund these large-scale financial obligations simply because "pay-as-you-go financing could inflict an excessive burden on the employer's working capital." Emerson H. Beier, *Financial Supplemental Unemployment Benefit Plans*, MONTHLY LAB. REV. 31, 31 (Nov. 1969). Although the trusts were required to perform all payroll-tax and information-reporting functions, the IRS had not issued guidance on the required payroll tax administration.

2. Treasury Department Initiatives And The Congressional Response

By 1968, tax administration had become a significant issue because, even though SUB payments were universally excluded from wages for purposes of FICA, FUTA, and FITW—as discussed *infra*—SUB payments were still subject to federal income taxes. As a result, recipients of SUB payments frequently found themselves with insufficient funds to pay their income taxes when they filed their year-end returns.

To address that situation, the Treasury Department undertook three coordinated payroll tax initiatives from 1968 to 1970: (1) it issued final information-reporting regulations under § 6041 confirming that SUB payments from any trust are reportable only on Forms 1099 (and thus are not wages); (2) it sought guidance from Congress on SUB payment

income-tax withholding; and (3) it issued regulations governing the information reporting of SUB payments in response to the congressional guidance. The government's brief references the second (legislative) initiative but fails to mention the first and third (regulatory) initiatives—a significant omission, as the reporting regulations are key to understanding the "present law" referenced by Congress in the legislative history when it enacted § 3402(o) in the first instance. The initiatives reflect a position at odds with the government's current argument.

As for the first initiative, section 6041 requires payers to "render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary." The 1968 "legislative" regulations—issued by the Treasury Department under this specific delegation of authority—address the information and payroll tax requirements for SUB payments under both §§ 501(c)(17) and 6041. These final regulations required Form 1099 information-reporting of SUB payments of $600 or more—and thus contemplate that SUB payments are excluded from wages for both FICA and FITW purposes. Treas. Regs. §§ 1.501(c)(17)-2(j) & 1.6041-2(b); see T.D. 6972, 1968-2 C.B. 222.

Forms 1099 are used to report income—and it has never been permissible for FICA taxes to be reported or withheld on Forms 1099. It is equally well established for information-reporting and tax-withholding purposes that Forms W-2, *Employee Wage and Tax Statement*, are used in lieu of Forms

1099 to report *both* FICA wages and FITW wages. Treas. Reg. § 1.6041-2(a). If SUB payments were wages (as the government now argues), reporting them on Form 1099 would have been impermissible.

Given the mandatory Form 1099 reporting imposed by the Treasury Regulations without any corresponding wage withholding, the Treasury Department not only recognized the amounts were exempt from FICA taxes, but it also precluded the amounts from being reported and withheld as wages for any employment-tax purpose covered by Subtitle C of the Code—including FICA. If the Treasury Department believed, as the government now insists, that all or even some portion of SUB payments were wages for FICA purposes, then it would have imposed the corresponding information-reporting and income-tax withholding requirements on Forms W-2. That it did not only reinforces that SUB payments, as defined in the Code, were excluded from wages for all employment-tax purposes in Subtitle C of the Code.

With respect to the second initiative, the Treasury Department asked Congress to address the significant income-tax payment issues by granting the Department authority to issue regulations permitting voluntary income-tax withholding. Instead, Congress intervened more directly by enacting § 3402(o), which imposed mandatory income-tax withholding by deeming SUB payments to be wages for FITW purposes—even though only a year earlier the Treasury Department had excluded such amounts from Form W-2 reporting and instead imposed Form 1099 reporting.

More specifically, section 3402(o) imposed income-tax withholding on SUB payments while recognizing that "although these benefits are not wages" they are "generally taxable income to the recipient" and "the absence of withholding on these benefits may require a significant final tax payment by the taxpayer receiving them." S. Rep. 91-552, *reprinted in* 1969 U.S.C.C.A.N. 2027, 2305. For purposes of imposing mandatory income-tax withholding, then, Congress defined SUB payments by adopting almost verbatim the definition of SUB payments set out in § 501(c)(17). Therefore, any payment that falls within that definition of a SUB payment shall be treated as if it were a payment of wages *solely* for FITW purposes.

The regulatory background and legislative history thus confirm what the text of the statute makes plain—SUB payments are not remuneration for services and are therefore excluded from wages for all Subtitle C purposes (i.e., FICA). As the Senate Report explained:

> *Present law*—Under present law, supplemental unemployment benefits are not subject to withholding *because they do not constitute wages or remuneration for services*.
>
> General reasons for change—[SUB payments] by employers are generally taxable income to the recipient. Consequently, the absence of withholding on these benefits may require a significant final tax payment by the taxpayer receiving them. The committee concluded that *although these benefits are not wages*,

> since they are generally taxable payments they should be subject to withholding to avoid the final tax payment problem for employees.

Ibid. (emphases added). The Senate Report concluded that "[t]he withholding requirements applicable to withholding on wages are to apply to these non-wage payments." *Id.* at 2306. As the court of appeals correctly concluded, the "necessary implication" of the italicized language is that "Congress did not consider [such] payments to be 'wages' but allowed their treatment as wages to facilitate federal income tax withholding." Pet. App. 11a-12a. If Congress intended to indicate that some of the payments described as "other than wages" actually were wages, it knew how to do so. But it did not, and as a consequence, *all* SUB payments, without distinction, are something "other than wages."

The government, however, contends (at 25) that the Senate Report's discussion of "present law" is "best understood to refer (somewhat imprecisely) to a series of IRS Revenue Rulings." "Somewhat imprecisely" indeed. The Senate Report is not obliquely referencing IRS rulings (which, after all, do not have the force of law) but Treasury Department regulations (which do) and under which all SUB payments, as defined in the Code, were exempt for FICA and FITW purposes. Particularly given that only four years earlier this Court had made plain that revenue rulings are no more than the opinions of the IRS, and lack the force and effect of law, *Dixon* v. *United States*, 381 U.S. 68, 73 (1965), Congress could not have considered the

revenue rulings relied upon by the government to be the "present law." In contrast, the Treasury Department's contemporaneous legislative regulations have the "force and effect of law," *Chrysler Corp.* v. *Brown*, 441 U.S. 281, 295 (1979), the same as the Code itself—and therefore comprise the "present law" referenced in the Senate Report.

As to the third initiative, the Treasury Department promulgated regulations the next year implementing the non-wage treatment of SUB payments as defined in the Code.[7] Specifically, the Treasury Department had to consider an alternative method for implementing § 3402(o)'s mandatory withholding because the mandatory Form 1099 reporting at that time did not contemplate or allow wage withholding for any Subtitle C purposes. New Treasury Department regulations issued in 1970 thus imposed the only method of information reporting available—Form W-2 reporting. See T.D. 7068, 1970-2 C.B. 252.[8]

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[7] Although the original exclusion contemplated SUB payments from trusts because they were the typical payors, even at that time there were non-trust payors, and the IRS eliminated that factor three years after recognizing its relevance. Rev. Rul. 60-330. Even under the government's most recent interpretation, the government concedes a trust is not required. *Ibid.*; Rev. Rul. 90-72.

[8] Not only are these regulations still in force, but also Form 1099 reporting is still required in certain situations where terminated workers receive amounts to which FITW is inapplicable. For example, a worker receiving a nominal SUB payment amount in the year following involuntary termination may be

(Continued on following page)

Mandatory Form W-2 reporting replaced Form 1099 reporting for SUB payments (as defined by the Code) paid after December 31, 1970, but only in response to and for the limited purpose of satisfying § 3402(o)'s deemed wage treatment, i.e., only for FITW purposes. See Treas. Regs. §§ 1.501(c)(17)-2(j) & 1.6041-2(b).[9]

But for § 3402(o), SUB payments retain their actual character as non-wages for FITW withholding and information-reporting purposes, further confirming that SUB payments similarly retain their status as non-wages for FICA purposes regardless of § 3402(o).

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exempt from actual FITW due to the number of personal allowances claimed on Form W-4, *Employee's Withholding Allowance Certificate*; therefore the worker would be issued a Form 1099 rather than a W-2 because these payments are understood not to be FICA wages.

[9] As already explained, the 1968 and 1970 reporting regulations specifically mention trusts because they were invariably used at the time to fund such large-scale payments. Other payors were not meant to be excluded. In the event that SUB payments were made directly by employers, Form W-2 reporting was already used—the amounts were simply not reported as wages. When Congress imposed mandatory FITW withholding on SUB payments, the 1968 regulations were rendered moot and SUB payments became reportable on Forms W-2, but not as wages. The upshot is that there was no need to issue regulations for non-trust payors because they already used Forms W-2 for federal income-tax withholding. In 1971, the IRS issued instructions to Forms W-2 and 941 explaining that despite the enactment of § 3402(o)(2), SUB pay was still not "wages" for FICA purposes.

B. Contemporaneous IRS Publications Show That SUB Payments Are Not Subject To FICA

As a matter of practice, the IRS's own contemporaneous forms confirm the conclusion that SUB payments are non-wages for purposes of FICA.

After the Treasury regulations were promulgated, the IRS issued Form 941, *Employer's Quarterly Federal Tax Return*, and Publication 15 (Circular E), *Employer's Tax Guide*, under the authority delegated to the Treasury Department by § 6041 for "true and accurate return[s] * * * in such form and manner and to such extent as may be prescribed by the Secretary." Among other payroll functions, these forms explain and implement § 3402(o)'s deemed FITW wage inclusion and the corresponding FICA wage exclusion for SUB payments.

The Circular E, *Employer's Tax Guide*—considered the Bible of payroll administrators—is issued annually by the IRS to provide a summary of the withholding, depositing, paying, and reporting requirements for FICA, FUTA, and FITW purposes. The front page of the 1971 Circular E alerts employers that income-tax withholding is required on SUB payments *after* December 31, 1970. Circular E specifically adopts the definition of SUB payments set forth in the Code and provides that SUB payments are exempt from FICA and FUTA, but subject to income-tax withholding. Circular E (1971) at 5, 16. All payors of SUB payments were advised to issue copies of Forms W-2 "as if wages had been paid." *Id.* at 9.

Circular E warns employers to "not include the amount of any * * * *supplemental unemployment compensation benefit* from which income tax has been withheld." *Id.* at 12 (emphasis added).

Form 941, *Employer's Quarterly Federal Tax Return*, is used by employers and payroll administrators to deposit and report both FICA and FITW tax amounts to the IRS. The General Instructions reflect § 3402(o) and advise that FITW includes SUB payments. The Specific Instructions, in turn, require employers and payroll administrators to include SUB payments in withheld deposit amounts for FITW purposes but caution employers to exclude those same amounts from taxable FICA and FITW wages. Form 941 at 4.

Form 941E, *Quarterly Return of Withheld Federal Income Tax*, was created for entities that report FITW but are otherwise exempt from FICA taxes. The Form applies to SUB trusts and allows them to report FITW amounts. No FICA taxes were or could be reported, withheld, or deposited on the Form 941E. As with the Form 941, it provides that SUB payments should be excluded from the "wages" in Item 1, but the actual amount of income taxes withheld on SUB payments should be included in Item 2. Form 941E, Specific Instructions at 4. Therefore, even though the amounts were now "wages" under § 3402(o), the forms did not treat them as wages but only tracked the income taxes that were required to be withheld for FITW purposes.

In sum, in its early forms that employers use to guide them in filing taxes, the IRS instructed employers that to prevent payees from facing end-of-the-year tax liability on SUB payments, income taxes had to be withheld. Critically, however, the forms did *not* contemplate FICA withholding.

C. Contemporaneous IRS Rulings Show That SUB Payments Are Not Subject To FICA

Contemporaneous IRS revenue rulings similarly comport with the statutory definition of SUB payments set forth in the Code. In 1977's Rev. Rul. 77-347, 1977-2 C.B. 362, for example, for SUB payments to be exempt from FICA, three conditions must be satisfied. First, the employee must involuntarily lose employment under the conditions imposed by the Code's definition of SUB payments. Second, the benefits must be computed based upon years of service and the employee's weekly earnings. Third, the benefits must not disqualify the terminated employee from receiving unemployment benefits.[10]

Although not a model of clarity (a common feature of the IRS SUB payment rulings), the ruling appears to indicate that if the payments merely satisfy § 3402(o), then they are excluded from wages for FICA

[10] Contrary to the government's position now, the IRS in earlier revenue rulings made clear that the existence of a union-negotiated arrangement and a trust were irrelevant. See Rev. Rul. 58-128, 1958-1 C.B. 89, and Rev. Rul. 60-330, respectively.

purposes (but are deemed wages for FITW purposes). The tie or link to unemployment benefits is thus "not a material or controlling factor" when determining whether a SUB payment is exempt from FICA taxes.

Similarly, another revenue ruling (on the payroll tax implications of a voluntary pre-retirement leave plan), in contrast to the two revenue rulings relied upon by the IRS for purposes of its own most-recent definition of SUB payments, provides:

> In order for a payment to qualify as a supplemental unemployment benefit payment under Rev. Rul. 56-249 and Rev. Rul. 60-330, the employee must have no right, title, or interest in the payment or the company contribution to provide the payment until the employee is laid off, and the payment must be made for a layoff that is involuntary on the part of the employee * * * * Both Code sections [501(c)(17) and 3402(o)] provide that the payment must be based on the involuntary separation of an employee from the employment of the employer only when such separation is one resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar condition.

Rev. Rul. 80-124, 1980-1 C.B. 212. Contrary to the government's current position, the IRS's position in the above rulings with respect to defining SUB payments—and consistent with the statutory definition of SUB payments—requires neither a trust nor a

connection to state unemployment benefits.[11] It is also consistent with leading SUB plan practices in 1969 (when § 3402(o) was enacted) that did not link SUB payments to state unemployment benefits. For example, among the earliest SUB plans were those

[11] To the extent a connection between SUB payments and unemployment benefits is even required, it already exists. Congress and state legislatures specifically recognize that terminated employees may simultaneously receive SUB payments as defined by Congress and extended state unemployment benefits—therefore, SUB payments as defined by Congress already have a connection to state unemployment benefits through FUTA, which imposes on the States a requirement that extended unemployment compensation must "be payable as provided by the Federal-State Extended Unemployment Compensation Act [FSEUCA] of 1970." 26 U.S.C. § 3304(a)(11). FSEUCA, in turn, pays extended unemployment benefits during periods of heavy and ongoing unemployment—including payments to many unemployed workers who are receiving SUB payments as defined by Congress. That definition is one component used by FSEUCA and § 3304(a)(11) to determine whether terminated workers are eligible for extended unemployment benefits. Again, we do not believe that a connection between SUB payments and unemployment benefits is required for SUB payments to be exempt from FICA taxation, but even if it were, that connection already exists and thus provides no reason to accept the IRS's definition of SUB payments. Indeed, virtually all 50 states—including the five largest—satisfy the FUTA requirement by specifically linking Congress's definition of SUB payments with their own statutory framework for extended unemployment benefits. See, e.g., CAL. UNEMP. INS. CODE § 4553(b) (Deering 2013); FLA. STAT. § 443.1115 (LexisNexis 2013); 805 ILL. COMP. STAT. 405/409(K)(3) (2013); N.Y. LAWS § 601 (LexisNexis 2013); TEX. CODE ANN. § 209.047 (LexisNexis 2013). Hence the government's concession (at 29) that state unemployment benefits would be denied if SUB payments were "wages."

for members of the United Auto Workers (which accounted for more than 30% of SUB participants in 1967). Beier, *supra* 12, at 31, 33. These UAW plans made SUB payments to downsized workers even though they were ineligible for state unemployment benefits for reasons such as refusal to accept available work, refusal to be available for work, and earnings above the unemployment-insurance limits.

D. Judicial Precedent Shows That SUB Payments Are Not Subject To FICA

The inconsistency in the government's positions does not stop with the revenue rulings. In *NYSA-ILA Container Royalty Fund* v. *Commissioner*, 847 F.2d 50 (2d Cir. 1988), the government asserted a position directly contrary to those it now pursues before this Court. In that case, the IRS had issued a Technical Advice Memorandum determining that the payments at issue "constitute supplemental unemployment benefits *within the meaning of Section 501(c)(17) and, therefore, are not wages for purposes of the FICA and the FUTA*." I.R.S. Tech. Adv. Mem. 79-37-003 (May 30, 1979) (emphasis added). The taxpayer subsequently filed and lost a refund suit seeking to extend the IRS's adoption of the statutory definition of SUB payments to benefits provided to dockworkers whose hours were reduced.

On appeal to the Second Circuit, the taxpayer contended that the benefits were SUB payments under § 3402(o) and, therefore, were excluded from "wages" for FICA and FUTA purposes. Contrary to its position

here, the government argued there that SUB payments and "wages" are "mutually exclusive." *NYSA-ILA*, 847 F.2d at 53. The Second Circuit agreed and, applying the definition of SUB payments in § 501(c)(17), recognized statutory SUB payments so defined are not subject to FICA, FUTA, or income-tax withholding. *Ibid.* Regarding income-tax withholding, the Second Circuit noted such statutory SUB payments became subject to FITW after 1970 because of § 3402(o). *Id*. at 52.[12]

III. The IRS Does An About Face In 1990 And Begins Issuing Revenue Rulings That Contravene Decades Of Established Understanding And Consistent Practice

In 1990, the IRS jettisoned decades of common understanding and practice when it issued a revenue ruling opining that § 3402(o) is irrelevant to defining SUB payments and, instead, "[f]or FICA and FUTA purposes, SUB Pay is defined *solely* through a series of administrative pronouncements published by the Service." Rev. Rul. 90-72 (emphasis added). Further, the ruling sought to alter the IRS's previous position (set out in Rev. Rul. 77-347) that the receipt of state unemployment benefits is immaterial to the analysis by instead requiring a direct connection between SUB

[12] As to the particular taxpayer before it, the Second Circuit held (consistent with the statutory definition) that the benefits in question were not SUB payments because they did not depend upon an "involuntary separation."

payments and the actual receipt of unemployment benefits. But if any ruling is entitled to deference, it would be Rev. Rul. 77-347. That contemporaneous ruling is the only one that actually analyzes, and conforms to, section 3402.

Of course, a revenue ruling is not entitled to the same deference as a statute or regulation, nor does it have the force of law. *Comm'r* v. *Schleier*, 515 U.S. 323, 336 n.8 (1995) ("[T]he Service's interpretive rulings do not have the force and effect of regulations." (quoting *Davis* v. *United States*, 495 U.S. 472, 484 (1990)) (internal quotation marks omitted)). Because the revenue rulings on which the government relies are not entitled to judicial deference under *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), they only have authority to the extent they have "power to persuade" under *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944). As this Court has explained, the extent of *Skidmore* "deference" depends on several factors, including the thoroughness of the ruling, the quality of its reasoning, and its consistency with other pronouncements. *United States* v. *Mead Corp.*, 533 U.S. 218, 228 (2001). Of particular relevance, this Court has declined to give any special weight to rulings where, as here, they conflict with the agency's earlier pronouncements. See, e.g., *Gen. Elec. Co.* v. *Gilbert*, 429 U.S. 125, 143 (1976) (citing *United Housing Found., Inc.* v. *Forman*, 421 U.S. 837, 858 n.25 (1975)), *superseded on other grounds by* 92 Stat. 2076, 42 U.S.C. § 2000e(k).

The IRS's position in Rev. Rul. 90-72 (on which it heavily relies in this case) departs radically from its post-§ 3402(o) rulings—with no reasoning or rationale for doing so. What is more, Rev. Rul. 90-72 does not address, much less attempt to explain, the departure from, among other things, this Court's decisions in *Rowan* and *Coffy*, the Second Circuit's decision in *NYSA-ILA*, the Treasury Department's information-reporting regulations, and the Treasury Department's SUB payment regulations that do not require ongoing unemployment to receive benefits. Devoid of reasoning and inconsistent with the IRS's previous pronouncements, the revenue ruling is entitled to no deference whatsoever.

In addition, the revenue ruling fails the requirement imposed by this Court in *Central Illinois Public Service* v. *United States*, 435 U.S. 21, 31 (1978), that an "employer's [payroll] obligation to withhold be precise and not speculative." In this case, the IRS's unexplained departure from decades of consistent practice leaves employers and payroll administrators struggling to piece together (from inconsistent rulings dating back more than half a century) when a payment is a SUB payment for FICA purposes, and when it is not.

Indeed, the definition of SUB payments proposed by the IRS is so imprecise that the IRS and the Federal Circuit, in *CSX Corp.* v. *United States*, 518 F.3d 1328 (Fed. Cir. 2008) (holding against the taxpayer), could agree on only five factors in the IRS's

unwieldy eight-factor test—and the IRS has not explained or analyzed why each of those factors is even relevant to the analysis. Compare Rev. Rul. 56-249, with *CSX Corp.*, 518 F.3d at 1335.[13]

Thus, in addition to being inconsistent with Congress's clear, objective approach in defining SUB payments in the "interest of simplicity and ease of administration," *Rowan*, 452 U.S. at 255 (citation and internal quotation marks omitted), the IRS's piecemeal approach fails *Central Illinois*' requirement of precision and should be rejected for that reason, too.

IV. The Government's Reliance On The 1983 "Decoupling Amendments" Is Misplaced

Much like the *Central Illinois* requirement, the *Rowan* principle that "Congress intended 'wages' to mean the same thing under FICA, FUTA, and income-tax withholding" for Subtitle C purposes, 452 U.S. at 255, is premised on "congressional concern for 'the interest of simplicity and ease of administration.'" *Rowan*, 452 U.S. at 255; *Central Illinois*, 435 U.S. at 27. Thus, as this Court explained in *Rowan*, "[c]ontradictory interpretations of substantially identical definitions do not serve that interest" and "[i]t would

[13] The Federal Circuit created a six-factor test as it dropped three of the IRS's factors (2, 5, and 6) and added a new one (payment of "substitute benefit").

be extraordinary for a Congress pursuing this interest to intend, without ever saying so, for identical definitions to be interpreted differently." 452 U.S. at 257.

In 1983, Congress responded by providing the Treasury Department with the flexibility to make distinctions *in its regulations* when defining wage exclusions between the FICA and income-tax withholding provisions. Called the "decoupling" amendments, these provisions state that "[n]othing *in the regulations* prescribed for purposes of chapter 24 (relating to income-tax withholding) which provides an exclusion from 'wages' as used in such chapter shall be construed to require a similar exclusion from 'wages' *in the regulation prescribed* for purposes of this chapter." 26 U.S.C. §§ 3121(a) & 3306(b) (emphases added).

As is apparent on their face, however, the decoupling amendments are not self-effectuating but are contingent upon the issuance of regulations making distinctions between wage exclusions for FICA and FITW purposes. Here, no such regulations have been issued—and that is fatal to the government's attempt to rely upon the amendments to decouple the SUB payment definition for FICA and FITW purposes. As the court of appeals correctly explained, the Treasury Department has not issued regulations adopting the IRS's approach to SUB payment, Pet. App. 16a—and in the absence of such regulations, the decoupling amendments do not apply and *Rowan* requires instead that the definition of wages under

FICA be construed consistently with the definition of wages for income-tax withholding purposes. The government's reliance on the decoupling amendments is thus misplaced.

V. Congressional Acquiescence Shows Approval Of The SUB Payment FICA Exclusion

For more than half a century, the government has consistently recognized that SUB payments are excluded from FICA wages. Now, for the first time to our knowledge, the government questions the validity of *all* of the IRS's SUB payment rulings—suggesting in a footnote that "it might reasonably have been disputed whether, as an original matter, the IRS was authorized to act as it did." Br. 30. As the government quickly points out, however, Congress has "effectively acquiesced in the IRS's approach." *Ibid.* Given the IRS's inconsistent rulings, however, the question is in which "approach" has Congress acquiesced?[14]

The government's own merits briefing displays the same inconsistency that has plagued the IRS's revenue rulings, as the government strongly defends those rulings on one page of its brief and then effectively denounces them on the next. Compare Br. 17-18, 29-30, and 32-34, with Br. 30 n.4. From a broader tax administration perspective, the inconsistency also underscores the serious ramifications that a ruling by

[14] To be clear, our argument is that Congress has acquiesced in the exclusion, not in the definition of the exclusion offered by the government in this case.

this Court accepting the government's position could have—that is, if the definition of SUB payments can be based "solely" on revenue rulings that do not have the force of law, then what other areas of tax law can be changed on the agency's whim simply by issuing a revenue ruling and declaring the agency's preferred result by fiat?

The SUB payment exemption from FICA taxes has been recognized by Treasury regulations and every court to examine the issue—including the Federal Circuit in *CSX Corp*. Where, as here, "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes," they are "deemed to have received congressional approval and have the effect of law." *United States* v. *Cleveland Indians Baseball Co*., 532 U.S. 200, 220 (2001) (quoting *Cottage Sav. Ass'n* v. *Comm'r*, 499 U.S. 554, 561 (1991) (quoting *United States* v. *Correll*, 389 U.S. 299, 305-06 (1967))) (internal quotation marks omitted). Thus "whether or not Congress can be said to have 'acquiesced' in the administrative practice, it certainly has not acted to change it * * * * In light of these substantial reliance interests, the longstanding administrative construction of the statute should 'not be disturbed except for cogent reasons.'" *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 457-58 (1978)

(quoting *McLaren* v. *Fleischer*, 256 U.S. 477, 481 (1921)).[15]

Here, Congress has not merely acquiesced in SUB payments being excluded from Subtitle C "wages" for more than 50 years, but also has affirmatively acted to create a statutory framework that supports, complements, and defines that exclusion as identified in the IRS's own rulings. For example:

- The legislative history of § 501(c)(17) references the IRS's SUB payments rulings, S. Rep. 86-1518, *reprinted in* 1960 U.S.C.C.A.N. at 3204;
- The legislative history of § 3402(o) specifically acknowledges that "present law" excludes SUB payments from "wages," S. Rep. 91-552, *reprinted in* 1969 U.S.C.C.A.N. at 2305;
- The FUTA provisions of Subtitle C connect SUB payments, as defined by Congress, with state legislatures for funding

[15] "Although the Service's interpretive rulings do not have the force and effect of regulations, see *Bartels* v. *Birmingham*, 332 U.S. 126, 132 (1947), we give an agency's interpretations and practices considerable weight where they involve the *contemporaneous construction* of a statute and where they have been in *long use*." *Davis* v. *United States*, 495 U.S. 472, 484 (1990) (emphases added) (citing, for example, *Norwegian Nitrogen Prods. Co.* v. *United States*, 288 U.S. 294, 315 (1933)). Unlike Rev. Rul. 90-72, Rev. Rul. 77-347 was contemporaneously constructed and used for a substantial time without challenge.

and computing extended unemployment benefits, see *supra* 23 n.11; and

- Section 419A acknowledges a distinction between SUB payments and severance, 26 U.S.C. § 419A(f)(1).

These data points demonstrate Congress's awareness and understanding of SUB payments—including the treatment of SUB payments as excluded from "wages" for Subtitle C purposes (i.e., FICA, FUTA, and FITW). And that understanding has a long pedigree. For example, section 3402(o), which acknowledged that SUB payments were excluded from wages under "present law," has remained unchanged for more than 40 years—even as the FITW provisions themselves have been amended at least 13 times. Similarly, the interplay between FUTA-FSEUCA and SUB payments as defined by Congress has not changed once in its more than 30-year existence—even though the FUTA definitional provisions have been amended more than 20 times. And the definition of SUB payments set forth in § 501(c)(17) has remained unchanged for more than half a century. The FICA SUB payment exclusion should therefore be "deemed to have received congressional approval and have the effect of law." *Cleveland Indians*, 532 U.S. at 220.

At the same time that Congress has "effectively acquiesced" in the SUB payment FICA exclusion at issue here, Congress has had multiple opportunities to adopt the definition of SUB payments urged in IRS revenue rulings and before this Court, but has not

done so. Instead, Congress restated its definition of SUB payments when it enacted § 3402(o)—and as set out above, it has referenced that same definition on other occasions since then.

* * *

In marked contrast to the continuity, consistency, and administrability of the statutory definition of SUB payments, the definition urged by the government has been cobbled together from several revenue rulings that are themselves inconsistent with the IRS's own rulings issued contemporaneously with § 3402. Furthermore, that definition is itself subject to change in order to accommodate "possible refinements in IRS practice," as the government puts it. Br. 34. But the evolving definition offered by the government has never been authorized by Congress. It has not been promulgated in regulations by the Treasury Department. And it reflects an abrupt and radical change in the IRS's own longstanding position. This Court should therefore decline the government's invitation to cast aside the well-established statutory definition of SUB payments that, unlike the government's definition, furthers the congressional purpose of simplicity and ease of administration highlighted by this Court in *Rowan*.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

ALLYSON N. HO
Counsel of Record
MORGAN, LEWIS & BOCKIUS LLP
1717 Main Street, Suite 3200
Dallas, Texas 75201
T. 214.466.4000
aho@morganlewis.com

DAVID R. FULLER
MARY B. HEVENER
MORGAN, LEWIS & BOCKIUS LLP
1111 Pennsylvania Avenue, N.W.
Washington, DC 20004
T. 202.739.3000

Counsel for Amicus Curiae
American Payroll Association