No. 10-1563

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re: QUALITY STORES, INC., et al., *Debtors*

UNITED STATES OF AMERICA,

Appellant

v.

QUALITY STORES, INC., et al.,

Appellees

ON APPEAL FROM THE ORDER OF THE UNITED STATES
DISTRICT COURT FOR THE WESTERN DISTRICT OF MICHIGAN

BRIEF FOR THE APPELLANT

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STATEMENT IN SUPPORT OF ORAL ARGUMENT

Oral argument should be heard in this case because it involves a question of significant nationwide importance. In addition, although the question presented is an issue of first impression in this Court, the decision below is in direct conflict with the decision of another federal circuit court.

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JURISDICTIONAL STATEMENT

On September 17, 2002, the post-confirmation estates of Quality Stores, Inc. and its affiliated companies (collectively "Debtors") timely filed refund claims with the Internal Revenue Service ("IRS") seeking a refund of federal employment taxes paid for the quarters ending December 31, 1999, through June 30, 2002. (RE 1-20, Jt. Stip. ¶8.)

I.R.C. § 6511(a) (26 U.S.C.).[1] The IRS did not act on the claims, and, on June 1, 2005, Debtors commenced this adversary proceeding against the Government. (RE 1-27, Complaint.) *See* I.R.C. §§ 6532(a)(1), 7422(a). The Bankruptcy Court had jurisdiction pursuant to 28 U.S.C. §§ 157 and 1334.

On November 25, 2008, the Bankruptcy Court entered final judgment in favor of Debtors. (RE 1-6.) On December 2, 2008, the Government timely appealed to the District Court. (RE 1-1.) Bankr. R. 8002(a). The District Court had jurisdiction pursuant to 28 U.S.C. § 158(a).

On February 23, 2010, the District Court entered an order affirming the judgment of the Bankruptcy Court. (RE 14.) The District Court's order is final and appealable. On April 23, 2010, the Government timely filed a notice of appeal to this Court. (RE 17.) *See* Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction pursuant to 28 U.S.C. § 1291.

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[1] Unless otherwise indicated, all section references herein are to the Internal Revenue Code of 1986, as amended (the "Code"). "RE _-_" refers to the District Court's record entry numbers and, where applicable, attachment number.

STATEMENT OF THE ISSUE

Whether the courts below erred in holding that the severance payments at issue, which admittedly did not qualify for exclusion from Federal Insurance Contributions Act (FICA) tax under Rev. Rul. 90-72, 1990-2 C.B. 211 (excluding certain supplemental unemployment compensation benefits from FICA tax), nevertheless did not constitute "wages" for FICA tax purposes.

STATEMENT OF THE CASE

In October 2001, an involuntary chapter 11 bankruptcy petition was filed against Quality Stores, Inc. Quality Stores answered the involuntary petition and consented to an order for relief, and its affiliates commenced voluntary chapter 11 cases in the Bankruptcy Court. In May 2002, the Bankruptcy Court confirmed Debtors' plan of reorganization.

In September 2002, Debtors filed claims for refund with the IRS seeking return of approximately $1 million in FICA taxes paid on severance payments made to its former employees. Debtors claimed that the severance payments did not constitute taxable wages for FICA purposes. The IRS did not act on the refund claims, and, in June 2005,

Debtors commenced an adversary proceeding in the Bankruptcy Court against the Government.

The parties filed a joint stipulation of facts and cross-motions for summary judgment. Following oral argument, the Bankruptcy Court (Gregg, J.) ruled in favor of Debtors in an opinion reported at 383 B.R. 67. Shortly thereafter, the Federal Circuit ruled in the Government's favor on the same issue in *CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008). The Government filed a motion for reconsideration in the Bankruptcy Court. The Bankruptcy Court reconsidered and affirmed its earlier ruling, and entered judgment in favor of Debtors.

The Government appealed to the District Court. In an opinion reported at 424 B.R. 237, the District Court (Neff, J.) affirmed. The Government now appeals to this Court.

STATEMENT OF FACTS

A. Debtors' severance payments to employees

Until the bankruptcy proceedings began, Debtors were the largest agricultural specialty retailer in the United States. (RE 1-20, Jt. Stip. ¶12.) Debtors' stores served the needs of predominantly rural

customers, including farmers, hobby gardeners, and skilled trade persons. (*Id.*)

On October 21, 2001, an involuntary petition under Chapter 11 of the Bankruptcy Code was filed against Quality Stores, Inc. On November 1, 2001, Quality Stores consented to the entry of an order for relief, and its subsidiaries filed voluntary petitions under Chapter 11 of the Bankruptcy Code. (RE 1-20, Jt. Stip. ¶2.)

Prior to the filing of the bankruptcy petitions, Debtors closed approximately 63 stores and nine distribution centers, and terminated 75 employees at their corporate office. After the petitions were filed, Debtors closed their remaining 311 stores and three distribution centers, and terminated the remainder of their corporate employees. (RE 1-20, Jt. Stip. ¶13.) In all, over 4,000 full-time employees were involuntarily terminated between 1999 through 2002. (RE 1-27, Complaint ¶12.) Debtors made severance payments to employees who were involuntarily terminated during both the pre-petition and post-petition periods. (RE 1-20, Jt. Stip. ¶¶13-14.)

The pre-petition severance payments were made pursuant to Debtors' severance plan then in effect. (RE 1-20, Jt. Stip. ¶19.) The

severance plan applied to employees who were "terminated for reasons not personal to the individual," including "a reduction in the level of business activity" and "the discontinuance or sale of a functional unit." (RE 1-20, Jt. Stip., Ex. A at 1.) Severance pay generally was "based upon job grade and management level in the organization" (*id.*) and was paid in accordance with Debtors' normal payroll period (RE 1-20, Jt. Stip. ¶22). As relevant here, under the terms of the pre-petition severance plan, senior executives received 12 to 18 months of severance pay, and all other employees received one week of severance pay for each full year of service. (*Id.* at ¶20.) The amount of the severance pay was equal to the employee's regular salary for the covered period. (RE 1-20, Jt. Stip., Ex. A at 2.)

The post-petition severance payments were made pursuant to a "modified severance plan" approved by the Bankruptcy Court. (RE 1-20, Jt. Stip. ¶25 & Ex. B.) The payments were "in consideration of [employees] deferring their job searches and dedicating their efforts and attention to the company," and were payable only to employees who "complete[d] their last day of service as scheduled by the company." (*Id.* at Ex. B.) Corporate officers received 6 to 12 months of

severance pay. Full-time salaried and hourly employees who had been employed for at least two years received one week of severance pay for each full year of service, up to a maximum of ten weeks for salaried employees and five weeks for hourly employees. Employees with less than two years of service received one week of severance pay. Severance payments under the post-petition plan were paid in a lump sum. (*Id.* at ¶28.) Approximately 900 employees who were hired by successor companies (*i.e.,* companies that purchased Debtors' assets) did not receive severance pay. (*Id.* at ¶¶26, 30.)

The severance pay for both pre-petition and post-petition periods was not dependent upon whether the recipient was eligible for or receiving state unemployment compensation, and it was not attributable to the rendering of any particular services. (RE 1-20, Jt. Stip. ¶¶21, 27.) In addition, payments were made regardless of whether the recipient became re-employed elsewhere. (*Id.* at ¶32.)

B. Debtors' refund claims

The Federal Insurance Contributions Act (FICA), I.R.C. §§ 3121-3128, imposes social security and Medicare taxes on both the employer and its employees with respect to "wages" paid to the employees.

Debtors withheld and paid over to the Government both income tax and FICA tax from all of the severance payments they made under the pre-petition and post-petition severance plans. Debtors also paid over to the Government the employer's share of FICA tax with respect to all of the severance payments made under both plans. (RE 1-20, Jt. Stip. ¶7.)

On September 17, 2002, Debtors filed refund claims with the IRS seeking a total refund of $1,000,125 in FICA tax for the quarters ending December 31, 1999, through June 30, 2002.[2] (RE 1-20, Jt. Stip. ¶8.) Debtors claimed that the severance payments qualified as "supplemental unemployment compensation benefits," which is defined for income-tax withholding purposes in I.R.C. § 3402(o)(2)(A) as "amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment . . . resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar

[2] The specific companies that filed refund claims are Central Tractor & Farm Country, Inc., Country General Inc., Quality Farm & Fleet Inc., and Quality Stores Services, Inc. (RE 1-20, Jt. Stip. ¶9.)

conditions, but only to the extent such benefits are includible in the employee's gross income" (hereinafter "SUB pay"). Debtors contended that I.R.C. § 3402(o), which states that SUB pay "shall be treated as if it were a payment of wages" for purposes of income-tax withholding, indicates that such payments do not fall within the general definition of "wages" for income-tax withholding purposes. Relying on the decision of the Court of Federal Claims in *CSX Corp. v. United States*, 52 Fed. Cl. 208 (2002) ("*CSX I*"), Debtors asserted that SUB pay also is not "wages" for FICA purposes under the Supreme Court's decision in *Rowan Cos. v. United States*, 452 U.S. 247 (1981), which held that the term "wages" should be interpreted consistently for both income-tax withholding and FICA tax purposes.

C. The adversary proceeding

The IRS did not act on Debtors' refund claims, and Debtors commenced an adversary proceeding against the Government seeking a refund. (RE 1-27, Complaint.) The parties filed cross-motions for summary judgment. Debtors renewed the argument contained in their refund claims, emphasizing the decision in *CSX I*. (RE 1-19, Debtors' SJ Mot.; RE 1-16, Debtors' Opp. to Gov. SJ Mot.)

The Government argued that the definition of wages for FICA purposes is governed solely by the relevant FICA statute, specifically, I.R.C. § 3121, which states that "the term 'wages' means all remuneration for employment" unless otherwise excepted. The Government pointed out that there is no exception for SUB pay in either the FICA statutes or Treasury regulations. The Government noted that although certain types of SUB pay are excluded from FICA tax as a result of a series of IRS Revenue Rulings beginning with Rev. Rul. 56-249, 1956-1 C.B. 488, and culminating with Rev. Rul. 90-72, 1990-2 C.B. 211, the severance payments at issue did not qualify under Rev. Rul. 90-72 because, among other things, they were not dependent upon the receipt of state unemployment compensation. The Government further argued that the income-tax withholding provision of I.R.C. § 3402(o) was irrelevant to determining whether the severance payments at issue were wages subject to FICA. Moreover, to the extent *Rowan* had any relevance, the Government argued that it was legislatively overruled in 1983 when Congress amended I.R.C. § 3121(a) by adding to its flush language the so-called "decoupling" provision, which provides that nothing in the income-tax withholding regulations

that provides for an exclusion from wages should be construed to require a similar exclusion from wages in the FICA tax regulations. (RE 1-18, Gov. SJ Mot.; RE 1-15, Gov. Opp. to Debtors' SJ Mot.)

The Bankruptcy Court ruled in favor of Debtors. The Bankruptcy Court observed that "[r]elying on the similarities in the definitions of 'wages' for purposes of FICA and income tax withholding, the treatment of 'supplemental unemployment compensation benefits' as non-wages in § 3402(o), and the Supreme Court's holding in *Rowan*, the *CSX* [*I*] court concluded that FICA taxes did not apply to the payments." (RE 1-13, Bankr. Op. 10.) The Bankruptcy Court agreed with *CSX I* (*id.* at 18), and rejected each of the Government's arguments in turn.

First, the Bankruptcy Court rejected the Government's argument that the decoupling amendment overruled *Rowan*. The court stated that the argument "has some superficial appeal" because "'Congress has indeed gone on record as saying that the income-tax withholding system and the FICA-tax withholding system each serves a different interest which may, in turn, dictate differences in the make-up of their respective wage bases.'" (RE 1-13, Bankr. Op. 12, quoting *CSX I*, 52

Fed. Cl. at 213.) However, the court agreed with *CSX I* that the decoupling amendment was not "self-executing" but, "[r]ather, 'its operation depends on the promulgation of regulations that in fact establish distinctions between wages for income-tax withholding purposes and wages for FICA-tax withholding purposes.'" (*Id.*)

The Bankruptcy Court next rejected the Government's reliance on the Revenue Rulings. The court stated that the requirements of the rulings had not been consistent over time, as the IRS repeatedly added and eliminated requirements. (RE 1-13, Bankr. Op. 14-15.) The court further opined that the Revenue Rulings gave no "cogent explanation" for the conclusion that the definition of SUB pay contained in I.R.C. § 3402(o) does not apply for FICA purposes. (*Id.* at 15.)

The Bankruptcy Court then rejected the Government's argument that the text of I.R.C. § 3402(o) belies the notion that SUB pay is not wages for FICA tax purposes. The Government had pointed out that, unlike SUB pay, the other two types of payments treated as if they were wages under I.R.C. § 3402(o)(1)—annuities and sick pay—are specifically excluded from wages under the FICA tax provisions. *See* I.R.C. § 3121(a)(2), (4), (5). The court stated that "[a]s the *CSX* [*I*] court

discussed in its detailed analysis of this argument, the reason for these exclusions is explained by the disparate nature of the types of payments."[3] (RE 1-13, Bankr. Op. 15.) The court continued that "annuity payments are considered 'remuneration for services' and are thus deemed 'wages' for purposes of both FICA and income tax withholding," although such payments "are specifically excluded from the definition of 'wages' under the two statutes." (*Id.* at 16.) The court stated that, "[s]upplemental unemployment compensation benefits, on the other hand, are not considered to be 'remuneration for services.'" (*Id.* at 16.) "Accordingly," the court stated, "these types of payments do not initially fall under the statutory definitions of 'wages,' and there is no good reason to specifically exclude them from FICA taxation." (*Id.*)

Finally, the Bankruptcy Court rejected the Government's reliance on *Appoloni v. United States*, 450 F.3d 185 (6th Cir. 2006). In that

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[3] In *CSX I*, 52 Fed. Cl. at 215, the Court of Federal Claims stated that I.R.C. § 3402(o)(1) concerns two types of payments, *to wit*, payments that constitute nonwage payments under existing law, *i.e.,* SUB payments and sick pay, and payments that constitute remuneration but that existing law excludes from the definition of wages, *i.e.*, annuities. The Court of Federal Claims then opined that payments that are nonwage payments from the start are beyond FICA taxation.

case, this Court held that severance payments made to teachers who gave up their tenure rights were wages subject to FICA tax, emphasizing that the term "wages" must be construed broadly. After noting that *Appoloni* did not concern SUB payments, the Bankruptcy Court opined that *CSX I* and *Appoloni* were consistent because in determining which of the various payments at issue in *CSX I* actually qualified as SUB pay, the *CSX I* court employed a narrow construction of SUB pay. (RE 1-13, Bankr. Op. 17-18.) *See CSX I*, 52 Fed. Cl. at 218-21; *CSX Corp. v. United States*, 71 Fed. Cl. 630 (2006) (supplementary decision).

Accordingly, the Bankruptcy Court entered an order requiring the Government to turn over the withheld funds to Debtors' bankruptcy estate. (RE 1-12.)

D. The Government's motion for reconsideration following the Federal Circuit's reversal of *CSX I*

Shortly after the Bankruptcy Court issued its opinion, the Federal Circuit reversed the decision in *CSX I*. *See CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008) ("*CSX II*"). In reaching its conclusion, the Federal Circuit recounted the historical tax treatment of severance

pay in great detail. The Federal Circuit first observed that the 1939 Internal Revenue Code contained an exception from FICA tax for dismissal payments but that, in 1950, the exception was eliminated by Congress. *Id.* at 1334. Thus, the court stated, "as of 1950, it was clear that all payments made by an employer on account of the involuntary separation of an employee from service constituted wages within the meaning of FICA." *Id.*

The court explained that, in the mid-1950s, in order to alleviate the hardship felt by separated employees, employers began to fund trusts to supplement the state unemployment compensation benefits received by separated workers. In order for these plans to be effective, however, it was critical that the supplemental payments not be considered wages, because state unemployment compensation was not available to individuals earning wages. With that in mind, the IRS issued Rev. Rul. 56-249, in which it defined SUB pay that would not be considered "wages" for either income-tax withholding or FICA tax purposes. Over the years, the IRS issued a number of rulings refining the definition of SUB pay. In 1960, Congress enacted I.R.C.

§ 501(c)(17) to provide an exemption from tax for trusts making SUB payments. *CSX II,* 518 F.3d at 1334-36.

The Federal Circuit explained that the problem developed that because the SUB payments were income, but were not "wages" for income-tax withholding purposes under the relevant rulings, recipients found themselves subject to large income tax obligations upon filing their tax returns. In order to solve that problem, the Treasury suggested an amendment to make SUB pay subject to income-tax withholding. In response, in 1969, Congress enacted I.R.C. § 3402(o). In the new provision, Congress defined SUB pay in a substantially similar manner to the definition contained in I.R.C. § 501(c)(17). In the accompanying report, the Senate Finance Committee stated that SUB payments were not subject to income-tax withholding under present law "because they do not constitute wages or remuneration for services," S. Rep. No. 91-552, at 268 (1969). *CSX II*, 518 F.3d at 1336-37.

After thus laying the framework for its decision, the Federal Circuit stated that it was "constrained to disagree with the trial court." *Id.* at 1340. The Federal Circuit reasoned that in enacting I.R.C.

§ 3402(o), "it was not important for Congress to define SUB payments narrowly or to distinguish between SUB payments and 'dismissal' payments, since both were treated similarly for withholding purposes," *i.e.,* both are subject to withholding. *Id.* The court pointed out that "the income tax withholding regulations have long contained co-existing provisions stating that dismissal payments and SUB payments (as defined in section 3402(o)) are subject to withholding, even though those two categories plainly overlap." *Id.* (citing Treas. Reg. (26 C.F.R.) § 31.3401(a)-1(b)(4) (defining dismissal payments) and Treas. Reg. § 31.3401(a)-1(b)(14)(ii) (defining SUB payments).) It stated that "the overlap between those two categories has presented no difficulties in the context of chapter 24 [concerning income-tax withholding], because the same consequence ensues – withholding – regardless of which category a particular payment is deemed to fall within." *Id.*

The Federal Circuit continued that "[t]he overlap between those two categories does cause problems, however, if section 3402(o) is construed to apply outside of chapter 24, such as to chapter 21 (FICA) . . . . Thus, if section 3402(o) is deemed to render all SUB payments (as

defined therein) non-wages, and if the non-wage character of SUB payments (as so defined) is deemed to apply to FICA, it creates a square conflict with the treatment of dismissal payments as wages under FICA since 1950 and in decisions of this court and others." *Id.* at 1341. The court explained that "[t]hat potential conflict argues against reading section 3402(o) to suggest that all payments falling within the statutory definition of SUB payments must be deemed non-wages for FICA purposes." *Id.* The Federal Circuit further observed that "[n]othing in the text of section 3402(o) requires that the statute be read to go that far," emphasizing that I.R.C. § 3402(o) expressly states that it "applies only for purposes of chapter 24 and certain procedural provisions relating to chapter 24." *Id.* The court stated that "Congress's decision to restrict the scope of the rule set forth in section 3402(o) to chapter 24 suggests that Congress did not intend that rule, or any implication that might be drawn from that rule, to be applied outside the context of income tax withholding." *Id.*

The Federal Circuit also rejected CSX's argument that the "shall be treated" language of I.R.C. § 3402(o) means that SUB pay is not wages in the first instance, stating that "the inference that CSX seeks

to draw from the statutory language is simply too strained." *Id.* at 1342. The court explained that "[t]o say that all payments falling within a particular category shall be treated as if they were a payment of wages does not dictate, as a matter of language or logic, that none of the payments within that category would otherwise be wages. For example, to say that for some purposes all men shall be treated as if they were six feet tall does not imply that no men are six feet tall." *Id.* at 1342. The court further observed that "section 3402(o) does not simply say that SUB payments shall be treated as wages; it provides that SUB payments shall be treated as if they were 'a payment of wages by an employer to an employee for a payroll period.' To say that certain payments do not constitute a payment of wages for a payroll period falls short of saying that the payments lack the legal character of 'wages' altogether." *Id.*

The Federal Circuit went on to rule that all of the separation payments at issue in the case constituted wages under I.R.C. § 3121. 518 F.3d at 1345-50.

The Government filed a motion for reconsideration in the Bankruptcy Court based upon the Federal Circuit's decision in *CSX II*.

(RE 1-11.) The Bankruptcy Court granted the motion and, without explanation, ratified its prior decision. (RE 1-10.)

E. The Government's appeal to the District Court

The Government appealed to the District Court, which affirmed. The District Court began its opinion by observing that "[t]he statutory enactments make clear that at some point a line is to be drawn on the taxation of employee financial benefits; otherwise, the benefits become the basis of the very taxes collected to return as benefits." (RE 13, Dist. Op. 12.) The court continued that "at one end of the spectrum are social security benefits and at the other end of the spectrum are wages/earnings, and at the point on the spectrum where severance payments are intended to serve the same purpose as social security benefits, i.e., support for workers in lieu of a lost ability to earn wages, the collection of social benefit taxes on the wage-replacement makes little sense." (*Id.*) Viewed in that light, the court was "persuaded that the severance payments at issue are properly viewed as wage-replacement social benefits, not taxable remuneration for the employees' services or wages." (*Id.*)

The District Court rejected the Government's argument that I.R.C. § 3402(o) does not control, stating that "[t]here is no justification for differing interpretations of 'wages' under the FICA and income tax withholding statutes." (RE 13, Dist. Op. 13.) The court further held that Rev. Rul. 90-72 did not satisfy the requirements of the decoupling amendment such that "the reasoning in *Rowan* remains controlling." (*Id.* at 14.)

The District Court also rejected the reasoning of the Federal Circuit in *CSX II*. After quoting the portion of the *CSX II* opinion that invoked the analogy to six-feet tall men, the court opined that "it is the above analogy to six-feet tall men that strains logic and effectively ignores clear statutory provisions." (RE 13, Dist. Op. 15.) The District Court stated that "[t]he clear import of § 3402(o) is that any payment meeting the definition of 'supplemental unemployment compensation benefits' in § 3402(o)(2) is not considered to be 'wages.' Otherwise, the additional statement, 'shall be treated as if it were a payment of wages by an employer to an employee for a payroll period' is not only unnecessary but also meaningless. . . . Similarly, if SUB pay already falls within the definition of 'wages,' there is no need to state that it

shall be treated as if it were wages. If the SUB pay is already 'wages,' it is already subject to income tax withholding." (*Id.* at 15.)

From that adverse decision, the Government brings this appeal.

SUMMARY OF ARGUMENT

1. The courts below erred in ruling that the severance payments at issue did not constitute wages for FICA tax purposes. First, they failed to analyze this question under the relevant FICA statute, I.R.C. § 3121(a). That section broadly defines wages as "all remuneration for employment," with very specific exceptions. I.R.C. § 3121(a) contains no exception for severance pay, and, indeed, Congress repealed an exclusion for "dismissal pay" in 1950. As the Federal Circuit held in *CSX II*, it has been clear since 1950 that dismissal payments occasioned by involuntary separations constitute wages under I.R.C. § 3121. Although the IRS has ruled, in Rev. Rul. 90-72, that dismissal payments that meet the requirements delineated therein are not subject to FICA tax, there is no dispute that the severance payments at issue do not qualify for such exclusion because they were not dependent upon eligibility for, or receipt of, state unemployment compensation.

Moreover, this Court repeatedly has held that the eligibility factors for payments provide a strong indication of whether the payments were wages. In this case, the severance payments were based on present employment, length of service, seniority, and base pay—all factors traditionally associated with determining an employee's remuneration for services. The payments at issue were therefore clearly wages under I.R.C. § 3121.

2. The courts below erred by focusing their analyses on I.R.C. § 3402(o)—an income-tax withholding provision—rather than on I.R.C. § 3121. By its very terms, I.R.C. § 3402(o) applies only to chapter 24 of the Code, which contains the income-tax withholding provisions, and not to chapter 21, which contains the FICA tax provisions. In any event, as the Federal Circuit held in *CSX II*, the language of I.R.C. § 3402(o) does not dictate that SUB pay is not wages in the first instance. The decision of the courts below is in direct conflict with the Federal Circuit on this point.

3. Irrespective of the continuing vitality of *Rowan*, that case was not properly applied by the lower courts here. If, as the lower courts held, I.R.C. § 3402(o) creates an exception resulting in treating

payments that would otherwise be wages under I.R.C. § 3121 as not being wages, by its terms it creates the exception for *income* tax withholding purposes only. The FICA provisions remained unchanged. Given that the purpose and effect of I.R.C. § 3402(o) is to make clear that SUB pay is subject to income-tax withholding, it is somewhat perverse to invoke *Rowan* to hold that I.R.C. § 3402(o) establishes that SUB pay is *not* subject to withholding for FICA tax purposes. Indeed, to the extent *Rowan's* holding relied on the view that the general Congressional policy of parallel treatment between the income tax and FICA tax provisions calls for similar provisions in each to be interpreted consistently, *Rowan* calls for treating SUB pay as being subject to FICA tax withholding, just as it is subject to income-tax withholding. Moreover, even if, as the courts below held, the 1983 amendment itself is not self-executing, the 1983 Congressional action clearly undermines the force of *Rowan*'s reasoning. Indeed, the legislative history of the 1983 amendment is unambiguous in explaining that Congress disagreed with *Rowan*'s reasoning that the term "wages" in the FICA and income-tax withholding provisions were intended to have the same meaning. Under these circumstances,

Rowan should not be read to require a provision that is found only in the income-tax withholding provisions, and that was intended to make clear the breadth of the coverage of those provisions, to dictate a narrow coverage for FICA tax purposes.

4. Finally, we submit that Congress legislatively overruled *Rowan* in 1983 when it enacted the decoupling provision. Indeed, four other federal circuit courts have so held. Thus, *Rowan* is no longer good law, and it should not trump the result under I.R.C. § 3121(a).

The decisions of the District Court and Bankruptcy Court should be reversed.

ARGUMENT

The courts below erred in holding that the severance payments at issue were not "wages" for purposes of FICA tax

Standard of review

When this Court reviews an appeal from the decision of a district court in a case originating in bankruptcy court, it directly reviews the decision of the bankruptcy court rather than the district court's review of the bankruptcy court's decision. *In re Cannon*, 277 F.3d 838, 849

(6th Cir. 2002). This Court reviews the bankruptcy court's grant of summary judgment *de novo*. *Id.*

The issue in this case is whether the severance payments made by Debtors constituted "wages" for purposes of FICA tax. The courts below erred in their analyses because they wholly failed to consider the question based on the governing FICA provision, I.R.C. § 3121. Rather than directly address whether the severance payments at issue were "wages" under I.R.C. § 3121 and this Court's precedents, the courts below "backed into" their determinations by examining statutory provisions applicable to *income*-tax withholding and then by invoking an inapplicable and, in any event, legislatively overruled Supreme Court ruling to make those provisions applicable to FICA.

Moreover, the decision below is in direct conflict with the Federal Circuit's decision in *CSX II*. In that case, the Federal Circuit correctly held that separation payments made to employees who were involuntarily terminated constituted wages under I.R.C. § 3121, and it rejected the argument that I.R.C. § 3402(o) creates an exception from FICA taxation for SUB pay.

A. The severance payments made by Debtors clearly were "wages" within the meaning of I.R.C. § 3121

1. FICA's definition of "wages"

The purpose of the Social Security Act is to provide funds for "the decent support of elderly workmen who have ceased to labor." *Social Sec. Bd v. Nierotko*, 327 U.S. 358, 364 (1946). As this Court has stated, "in dealing with the beneficent purposes of the Social Security Act, this court generally favors that interpretation of statutory provisions which calls for coverage rather than exclusion." *St. Luke's Hosp. Ass'n v. United States*, 333 F.2d 157, 164 (6th Cir. 1964); *see United States v. Detroit Medical Center*, 557 F.3d 412, 414 (6th Cir. 2009).

FICA imposes employment taxes on employers and employees that are measured by the "wages" paid to, or received by, an employee "with respect to employment." I.R.C. §§ 3101(a), 3111(a). I.R.C. § 3121(a) defines "wages" as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash," other than 23 enumerated exclusions that are inapplicable in this case. "Employment" is defined as "any service, of whatever nature, performed . . . by an employee for the

person employing him," with exceptions not relevant here. I.R.C. § 3121(b). The "name," "basis," or "medium" by which the payment is made is "immaterial" in determining whether the remuneration constitutes "wages." Treas. Reg. § 31.3121(9)-1(c), (d), (e).

Courts have repeatedly held that the term "wages" is to be interpreted broadly in accordance with the remedial purposes of the Social Security Act. In *Nierotko*, the Supreme Court held that back pay that was paid to a worker who had been wrongfully discharged from employment qualified as "wages" under the Social Security Act, even though the pay was attributable to periods in which the worker performed no services. The Supreme Court stressed that the statutory definition of "wages" is not limited to "work actually done," and instead encompasses the entire employer-employee relationship for which compensation is paid:

> The very words "any service . . . performed . . . for his employer," with the purpose of the Social Security Act in mind import breadth of coverage. They admonish us against holding that "service" can be only productive activity. We think that "service" as used by Congress in this definitive phrase means not only work actually done but *the entire employer-employee relationship for which compensation is paid* to the employee by the employer.

327 U.S. at 365-66 (emphasis added). *See also United States v. Silk*, 331 U.S. 704, 711-12 (1947) ("[t]he very specificity of the exemptions . . . and the generality of the employment definitions indicates that the terms 'employment' and 'employee,' are to be construed to accomplish the purposes of the legislation").

Since *Nierotko*, the courts of appeals, including this Court, have repeatedly held that the definition of "wages" in I.R.C. § 3121 must be broadly construed. *See, e.g., Detroit Medical Center*, 557 F.3d at 414; *Appoloni,* 450 F.3d 185; *Gerbec v. United States*, 164 F.3d 1015, 1026 (6th Cir. 1999); *Sheet Metal Workers Local 141 Supp. Unemp. Benefit Trust v. United States*, 64 F.3d 245, 251 (6th Cir. 1995); *CSX II*, 518 F.3d at 1333; *Associated Electric Coop., Inc. v. United States*, 226 F.3d 1322, 1326-1327 (Fed. Cir. 2000); *Hemelt v. United States*, 122 F.3d 204, 209 (4th Cir. 1997).[4]

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[4] As this Court recognized, this construction of the relevant terms is consistent with "the well-settled principles that 'exemptions from taxation are to be construed narrowly' and 'do not rest upon implication,' but 'must be unambiguously proved.'" *Detroit Medical Center*, 557 F.3d at 414-15 (citations omitted).

With respect to severance pay, I.R.C. § 3121 contains no exclusion from the definition of "wages" for severance pay. Prior to 1950, "dismissal pay" was specifically excluded from FICA's definition of wages. *See* Social Security Act Amendments of 1939, Pub. L. No. 76-379, ch. 666, 53 Stat. 1360, 1384, codified at I.R.C. § 1426(a)(4) (1939 Code). In the Social Security Act Amendments of 1950, Congress repealed the exclusion. *See* Pub. L. No. 81-734, ch. 809, 64 Stat. 477. The legislative history states that:

> Section 1426(a) as amended by the bill contains no provision comparable to paragraph (4) of existing law which excludes from the term "wages" dismissal payments which the employer is not legally required to make. Therefore, *a dismissal payment, which is any payment made by an employer on account of involuntary separation of the employee from the service of the employer, will constitute wages* subject, of course, to the $3,600 limitation [*i.e.*, the wage base at that time], irrespective of *whether the employer is, or is not, legally required to make such payment*.

H.R. Rep. No. 1300, 81st Cong., 1st Sess. 124 (1949) (italics added). "When Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect." *Stone v. INS*, 514 U.S. 386, 397 (1995). Thus, as the Federal Circuit observed, there can be no dispute that, since 1950, dismissal pay constitutes wages for purposes

of FICA tax. *CSX II*, 518 F.3d at 1334; *Abrahamsen v. United States*, 228 F.3d 1360, 1364 (Fed. Cir. 2000) ("severance" payments or "dismissal" payments are FICA "wages").

As explained by the Federal Circuit in *CSX II* (*see* discussion *supra,* pp. 15-16), the IRS, through a series of Revenue Rulings, has carved out a limited exception for certain types of dismissal pay that, among other things, supplement state unemployment compensation benefits paid to terminated employees. In the most recent of these rulings, Rev. Rul. 90-72, the IRS clarified that the payments must "be linked to state unemployment compensation in order to be excluded from the definition of wages for FICA," as that aspect is critical to the "underlying premises for the exclusion."[5] 1990-2 C.B. at 212. Debtors

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[5] The courts below criticized the IRS as having "charted a path of 'reverse-course' rulings on this issue since the 1950s" (RE 13, Dist. Op. 4) and as having treated SUB pay inconsistently over time (RE 1-13, Bankr. Op. 14), but this is not accurate. All of the relevant rulings, other than one, required payments to be linked to state unemployment compensation in order to qualify for exclusion from FICA. *See* Rev. Rul. 56-249; Rev. Rul. 58-128, 1958-1 C.B. 89; Rev. Rul. 60-330, 1960-2 C.B. 46; Rev. Rul. 65-251, 1965-2 C.B. 395; Rev. Rul. 71-408, 1971-2 C.B. 340; *cf.* Rev. Rul. 77-347, 1977-2 C.B. 362. In Rev. Rul. 90-72, the IRS revoked the errant ruling (Rev. Rul. 77-347) to "restore[ ] the distinction between SUB pay and dismissal pay by re-establishing the

(continued...)

have conceded that the severance payments at issue do not qualify for exclusion under the Revenue Ruling because, among other things, the payments were not tied to eligibility for, or receipt of, state unemployment compensation. (RE 1-19, Debtors' SJ Mot. at 16, n.9; RE 8, Debtors' Ans. Br. at 40, n.17; RE 13, Dist. Op. 6.)

This Court has held that severance payments constituted wages for FICA tax purposes on at least two occasions. Of particular relevance here, in *Sheet Metal Workers*, 64 F.3d 245, this Court held that payments made to employees from a liquidated supplemental unemployment benefit trust constituted wages. The trust was a tax-exempt trust maintained "to provide supplemental unemployment benefits, accident and sickness disability benefits, and severance pay to union members who were involuntarily unemployed." *Id.* at 247 & n.1. The trust was liquidated when the union branch merged with another branch, and each union member who had an account in the trust

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[5](...continued)
link between SUB pay and state unemployment compensation set forth in Rev. Rul. 56-249." Rev. Rul. 90-72 has been in force for 20 years and was cited favorably by the courts until *CSX I*. *See, e.g., Abrahamsen*, 228 F.3d at 1364; *Associated Elec. Coop.*, 42 Fed. Cl. at 874; *LTV Steel Co. v. United States*, 2002 WL 1310284, *2, n.4 (Fed. Cl. 2002).

received his or her positive account balance. (There was no dispute that such amounts constituted wages. *Id.* at 247.) Members who had participated in the trust for five or more consecutive years also received a proportionate share of the residual account balance. The trust argued that those payments were not wages because they were not distributed in return for services rendered, but were "merely payments from a reserve generated by prudent investments and competent administration of the contributions made to the Fund over a period of years." *Id.*

This Court rejected the argument. After reviewing several decisions of other courts, the Court stated that "we agree that eligibility requirements provide the most accurate test to determine whether a payment is truly in consideration for services." *Id.* at 251. The Court observed that eligibility for a share of the residual account balance "was directly contingent on past or present employment." *Id.* at 250-51. The Court held that "where the disputed payments are derived *solely* from employer contributions and are contingent on work requirements or their equivalents, the distributions are wages under FICA." *Id.* at 251 (emphasis in original).

This Court applied similar criteria in *Appoloni*, 450 F.3d 185, which held that voluntary early retirement payments made to tenured teachers constituted wages for FICA tax purposes. After emphasizing the "broad, inclusive nature" of the definition of wages, *id.* at 190, the Court stated that "[i]n determining whether a payment constitutes wages, courts have looked to eligibility requirements, specifically longevity, as an important factor," *id.* at 191. It stated that "[w]e have consistently held that where a payment arises out of the employment relationship, and is conditioned on a minimum number of years of service, such a payment constitutes FICA wages." *Id.* The Court rejected the argument that the payments were made in exchange for tenure rights, observing that they "were essentially severance payments," and stating that "[c]ourts have consistently held that severance payments for the relinquishment of rights in the course of employment relationship are FICA wages." *Id.* at 193. The Court was "at a loss to find a case, other than the Eighth Circuit's decision [in

North Dakota State Univ. v. United States, 255 F.3d 599 (8th Cir. 2001)], to hold otherwise."[6] *Id.*

2. The severance payments at issue clearly were "wages" under I.R.C. § 3121

Based on the foregoing authorities, it is clear that the severance payments at issue were "wages" within the meaning of I.R.C. § 3121. First, they were dismissal payments, *i.e.,* "any payment made by an employer on account of involuntary separation of the employee from the service of the employer." H.R. Rep. No. 1300, 81st Cong., 1st Sess., at 124. As the Federal Circuit in *CSX II* stated, in ruling that the separation payments at issue constituted wages, "it has been clear since the 1950 amendment to FICA that dismissal payments occasioned by involuntary separations constitute wages under FICA." 518 F.3d at 1346. The courts below gave no consideration to this point whatsoever.

Second, the severance payments were "remuneration for employment." I.R.C. § 3121(a). Although they were not attributable to

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[6] In *North Dakota State Univ.*, the Eighth Circuit held that payments made to professors who participated in an early-retirement program were made in exchange for the relinquishment of tenure rights the professors had acquired and thus were not wages subject to FICA tax.

the rendering of any particular services, they nevertheless were part of "the entire employer-employee relationship for which compensation [was] paid to the employee by the employer." *Nierotko*, 327 U.S. at 366. *See Gerbec*, 164 F.3d at 1026 ("We hold that the phrase 'remuneration for employment' includes certain compensation in the employer-employee relationship for which no actual services were performed.") Moreover, the payments made under the post-petition severance plan were dependent upon the continued performance of services generally, as they were paid "in consideration of [employees] deferring their job searches and dedicating their efforts and attention to the company" until their last scheduled work day. (RE 1-20, Jt. Stip., Ex. B.)

Third, the eligibility requirements for the severance payments establish that they were wages. The payments were directly contingent on present employment, varied according to seniority and length of service, and were calculated according to each employee's base pay. (*Id.,* Exs. A & B.) *See Appoloni*, 450 F.3d at 191 ("We have consistently held that where a payment arises out of the employment relationship, and is conditioned on a minimum number of years of service, such a payment constitutes FICA wages."); *Sheet Metal Workers*, 64 F.3d at

251 (where payments "are contingent on work requirements or their equivalents, the distributions are wages under FICA"); *Abrahamsen*, 228 F.3d at 1365 (severance payments based on departing employee's salary and years of service were FICA wages). Because the severance payments were "based on factors traditionally used to determine employee compensation, specifically, the value of the services performed by the employee, and the length of the employee's employment," they were wages for FICA tax purposes. *Sheet Metal Workers*, 64 F.3d at 250 (*quoting Lane Processing Trust v. United States*, 25 F.3d 662, 665 (8th Cir. 1994)).

B. Nothing in I.R.C. § 3402(o) affects whether the severance payments were wages for FICA tax purposes

The courts below failed to conduct any analysis whatsoever under I.R.C. § 3121. Instead, they focused on I.R.C. § 3402(o), an *income*-tax withholding provision, as bearing upon the definition of wages in I.R.C. § 3121. As the Federal Circuit in *CSX II* correctly held, however, I.R.C. § 3402(o) has no bearing on whether SUB pay is wages for purposes of FICA.

The lynchpin of the opinions below was the courts' view that the "shall be treated" language of I.R.C. § 3402(o) establishes that SUB pay is not wages for income-tax withholding purposes in the first instance. I.R.C. § 3402(o)(1) states that "[f]or purposes of this chapter [*i.e.,* chapter 24] (and so much of subtitle F as relates to this chapter)," "any supplemental unemployment compensation benefit paid to an individual . . . shall be treated as if it were a payment of wages by an employer to an employee for a payroll period." As the Federal Circuit observed in *CSX II*, 518 F.3d at 1341, the plain language of the statute limits its applicability to chapter 24, which speaks only to income-tax withholding, and those portions of subtitle F (procedure and administration) that relate to chapter 24. The FICA tax provisions are contained in chapter 21 of Code and, thus, I.R.C. § 3402(o)—by its own terms—has no application to FICA. The courts below wholly failed to give effect to this limiting language.

Instead, the courts below latched onto the *CSX I* court's view—which was reversed on appeal—that SUB pay "falls outside the definition of wages from the start." 52 Fed. Cl. at 216. (RE 1-13, Bankr. Op. 10, 16; RE 13, Distr. Op. 13.) This view was based on the

1969 Senate Finance Committee report regarding the enactment of I.R.C. § 3402(o). *Id.* In that report, the committee stated that "[u]nder present law, supplemental unemployment benefits are not subject to withholding because they do not constitute wages or remuneration for services." S. Rep. No. 91-552, at 268. The courts, however, placed undue reliance on this statement. First, there is nothing in the Internal Revenue Code that states that SUB pay is not wages. Second, the statement was a recitation of "present law," which necessarily refers to the IRS's Revenue Rulings regarding SUB pay. At the time, all dismissal pay was considered wages for FICA tax purposes, except for those types of SUB pay that the IRS had ruled were excluded from FICA and income-tax withholding. *See* Rev. Rul. 56-249; Rev. Rul. 58-128; Rev. Rul. 60-330; Rev. Rul. 65-251.[7] The exclusion was limited to severance pay that, among other things, supplemented state unemployment compensation benefits. Nothing in the Committee report (and no other legal authority) suggests that SUB pay, by

[7] Congress's use of the term "*supplemental* unemployment benefits" shows that it was referring to the SUB pay addressed in the Revenue Rulings.

inherent nature, is not wages. Therefore, there is no basis for the courts' view that SUB pay falls outside the general definition of wages, separate and apart from the exclusions provided in the Revenue Rulings.

As the Federal Circuit held in *CSX II*, I.R.C. § 3402(o) covers not only SUB payments that are not wages for income-tax withholding purposes, *i.e.*, those SUB payments excluded under the Revenue Rulings, but also payments that would qualify as wages in any event. 518 F.3d at 1341-42. It is hardly unusual for Congress to draft a statute with a reach broader than the specific problem that triggered the legislation. *See, e.g., Henry E. & Nancy Horton Bartels Trust v. United States*, 209 F.3d 147, 153-54 (2d Cir. 2000). And there are at least two reasons for defining SUB pay broadly in the income-tax withholding context. First, to the extent Congress was trying to reach the types of SUB pay that were excluded by the Revenue Rulings, the number of rulings issued prior to 1969, and their varying requirements, may explain Congress's decision to define SUB pay broadly in I.R.C. § 3402(o). Second, I.R.C. § 3402(o) is an inclusionary provision intended to subject SUB pay to income-tax withholding. Thus, it is

logical that Congress would cast a wide net that would encompass more than just the specific types of SUB pay carved out by the Revenue Rulings.

The District Court's criticism (RE 13, Dist. Op. 15) of the analogy the Federal Circuit used in *CSX II* to illustrate this point misses the mark. The District Court disagreed with the Federal Circuit's interpretation of I.R.C. § 3402(o), stating that "[i]f the underlying presumption in § 3402(o) was that SUB payments were both wages and non-wages depending on the particular case, that distinction could easily have been made in the statute." (*Id.*) That Congress could have more clearly worded the statute hardly means that the interpretation of the Federal Circuit is incorrect. And, the District Court was incorrect in stating that the "shall be treated" language of the statute is unnecessary under the Federal Circuit's interpretation. That language is necessary with respect to SUB pay that is excluded from wages under the Revenue Rulings; such SUB pay must be treated "as if it were a payment of wages" to be subject to income-tax withholding.

Finally, the interpretation of the courts below also is called into question by the structure of I.R.C. § 3402(o). That provision treats as

wages for income-tax withholding purposes three types of payments that are defined to otherwise not be wages, *to wit*, SUB pay, annuity payments, and sick pay. I.R.C. § 3402(o)(1)(A), (B), (C). The FICA provisions expressly exclude annuity payments and sick pay from "wages." *See* I.R.C. § 3121(a)(2), (a)(4), (a)(5). Under the reasoning of the courts below, however, there would be no need for those exclusions because, in their view, I.R.C. § 3402(o) defines annuities and sick pay, like SUB pay, as not being wages. In reconciling this point, the courts below found the reasoning of the Court of Federal Claims in *CSX I* persuasive. There, the court stated that I.R.C. § 3402(o)(1) covers two types of payments, *to wit*, payments that are not wages in the first instance, such as SUB pay and sick pay, and payments that are statutorily excluded from wages, such as annuities. *CSX I*, 52 Fed. Cl. at 215-16. But, even if this is correct, it does not explain why the FICA provisions contain an exclusion for sick pay, a payment the court classified as not being wages in the first instance. Moreover, the Court of Federal Claims's view that SUB pay is of a non-wage character was based on the 1969 Senate Report, *id.* at 216, a view that is incorrect, as discussed above.

The bottom line is that if, as the lower courts held, I.R.C. § 3402(o) created an exception resulting in treating payments that would otherwise be wages under I.R.C. § 3121 as not being wages, by its terms it creates the exception for *income*-tax withholding purposes only. The FICA provisions, which contain no such exception, remained unchanged.[8]

C. Even if SUB pay is not wages for income-tax withholding purposes, *Rowan* does not provide a basis for applying the same rule in the FICA context

Even if I.R.C. § 3402(o) were interpreted as establishing that SUB pay is not wages for income-tax withholding purposes, there is no basis for applying that same rule in the FICA context. The courts below relied on the Supreme Court's decision in *Rowan* to extend I.R.C. § 3402(o) to the FICA context. While, as discussed in detail *infra*, we submit that *Rowan* was legislatively overruled, irrespective of the continuing vitality of *Rowan*, that case was not properly applied here.

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[8] We also note that it is somewhat odd to have a SUB payment that does not actually supplement something. After all, I.R.C. § 3402(o) expressly refers to *supplemental* unemployment compensation benefits.

1. The result below is inconsistent with the thrust of *Rowan*

First, assuming that *Rowan* remains good law, the result below is inconsistent with *Rowan*'s ultimate holding. *Rowan* involved the validity of a Treasury regulation that interpreted the term "wages" for FICA tax purposes to include the value of meals and lodging provided to employees for the convenience of the employer. The value of such meals and lodging was exempt from income tax, however, and, as a result, the Treasury regulations did not require income-tax withholding on such payments. 452 U.S. at 250-51. The Supreme Court observed that the term "wages" is used in both the FICA and income-tax withholding statutes, and stated that "[i]n view of this sequence of consistency, the plain language of the statutes is strong evidence that Congress intended 'wages' to mean the same thing" in these provisions. *Id.* at 255. The Court stated that the histories of these provisions also indicated that Congress intended to coordinate the income-tax withholding provisions with the FICA provisions in order "to promote simplicity and ease of administration." *Id.* at 257. In striking down the regulation that treated meals and lodging as wages for FICA purposes,

the Court concluded that "[c]ontradictory interpretations of substantially identical definitions do not serve that interest." *Id.* at 257.

In this case, the decision below results in SUB pay being treated differently for FICA purposes than for income-tax withholding purposes, which is precisely what *Rowan* sought to avoid. Even if SUB pay is not wages in the first instance, I.R.C. § 3402(o) requires it to be treated as if it were wages, such that income tax is withheld from SUB pay. At the same time, however, the courts below refused to treat SUB pay as wages for FICA purposes, resulting in inconsistent treatment of SUB pay for FICA and income-tax withholding purposes. Given that the purpose and effect of I.R.C. § 3402(o) is to make clear that SUB pay is subject to income-tax withholding, it is somewhat perverse to invoke *Rowan* to hold that I.R.C. § 3402(o) establishes that SUB pay is *not* subject to FICA tax. Indeed, to the extent *Rowan's* holding relied on the view that the general Congressional policy of parallel treatment between the income tax and FICA tax provisions calls for similar provisions in each to be interpreted consistently, *Rowan* calls for

treating SUB pay as being subject to FICA tax, just as it is subject to income-tax withholding.

2. Congress has expressly disavowed *Rowan*'s interpretation of Congressional intent

Even if, as the courts below held, the 1983 decoupling amendment itself is not self-executing, the 1983 Congressional action clearly undermines the force of *Rowan*'s reasoning. Even the Bankruptcy Court acknowledged that, only two years after *Rowan* was decided, Congress went "on record as saying that the income-tax withholding system and the FICA-tax withholding system each serves a different interest which may, in turn, dictate differences in the make-up of their respective wage bases."[9] (RE 1-13, Bankr. Op. 12.) But Congress said even more—it expressly disavowed the holding and reasoning of *Rowan*.

As discussed earlier, the Supreme Court in *Rowan* struck down a FICA tax regulation that subjected a payment to FICA tax that was not

[9] Indeed, the FICA and income-tax withholding statutes contain separate, differently-worded definitions of the term "wages." *Compare* I.R.C. § 3121(a) *with* I.R.C. § 3401(a). If Congress had intended the term to have identical meanings in the two contexts, it could have easily achieved that end by providing identical definitions or cross-referencing the definitions. It did not do so.

subject to withholding under the income-tax withholding regulations. In the Social Security Act Amendments of 1983, Pub. L. No. 98-21, § 327, 97 Stat. 127 (the "1983 Act"), Congress enacted a statutory exclusion to give effect to *Rowan*'s holding regarding the value of meals and lodging (I.R.C. § 3121(a)(19)), but it otherwise made clear its disagreement with *Rowan* by adding the decoupling flush language to I.R.C. § 3121(a). Thus, the addition of the flush language to I.R.C. §3121(a) by the 1983 Act (providing that regulations under the FICA need not contain the same exemptions as regulations under the income tax withholding provisions) directly overruled the holding of *Rowan*. Accordingly, it cannot be disputed that Congress overruled the specific holding of *Rowan* that regulations under the FICA and income-tax withholding provisions had to contain the same exemptions from tax.

Further, the legislative history is unambiguous in explaining that Congress also disagreed with *Rowan*'s broader reasoning that the term "wages" in the FICA and income-tax withholding provisions were intended to have the same meaning. Contrary to *Rowan*'s reasoning that Congress intended to coordinate the FICA and income-tax withholding provisions (452 U.S. at 257), the legislative history to the

1983 Act explains that such parity of meaning is inappropriate, because "the social security system has objectives which are significantly different from the objectives underlying the income tax withholding rules." H.R. Rep. No. 25, 98th Cong., 1st Sess. at 80 (1983). Unlike income-tax withholding, which is designed to ensure that an employee does not have a large final tax bill that the employee is unable to pay, "[t]he social security program aims to replace the income of beneficiaries when that income is reduced on account of retirement and disability." *Id.*[10] Thus, the 1983 Act shows that Congress intended for

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[10] Given the fact that income-tax withholding serves a different purpose than FICA-tax withholding, the income-tax and FICA-tax withholding regimes, while similar in certain respects, are different in other respects. Income-tax withholding is simply an administrative device by which a person's estimated income tax is paid in advance, thereby ensuring both that the Government is paid and that the taxpayer avoids a large tax bill at year's end. *See United States v. American Friends Service Committee*, 419 U.S. 7, 10, n.6 (1974); *Peoples Life Ins. Co. v. United States,* 373 F.2d 924, 933 (Ct. Cl. 1967). A person's ultimate income tax liability, however, is not determined until year's end, at which point it may be determined that the person owes more or less tax than the amount that was withheld from his wages. *See Cleveland v. Commissioner*, 600 F.3d 739, 741-42 (7th Cir. 2010) ("[Income tax w]ithholding . . . occurs throughout the tax year while the tax liability is inchoate.") FICA-tax withholding is qualitatively different. Once it is determined that FICA tax must be withheld from a person's wages, there is no question that the person is liable for FICA

(continued...)

the term "wages" in the FICA provisions to serve as "the measure used both to define income which should be replaced and to compute FICA tax liability." *Id*. Consistent with the divergent purposes of the FICA provisions and the income-tax withholding provisions, the committee reports uniformly state that "the determination whether or not amounts are includible in the social security wages base is to be made without regard to whether such amounts are treated as wages for income tax withholding purposes." *Id*; S. Rep. No. 23, 98th Cong., 1st Sess. at 42 (1983); H.R. Conf. Rep. No. 47, 98th Cong., 1st Sess. at 148 (1983). The new provisions were made effective for remuneration paid after December 31, 1983. Pub. L. No. 98-21, § 327(d)(1).

But this was not Congress's last word on the matter. In 1984, concerned that *Rowan* could lead to significant refund claims for prior periods, Congress decided to make the decoupling provision effective retroactively. *See* Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 2662(g), 98 Stat. 1160. The House Report reflects Congress's intent to negate any lingering effects of *Rowan*'s reasoning:

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[10](...continued)
tax (up to the statutory limit).

> The Social Security Amendments of 1983 provided that . . . the determination of whether or not amounts are includible in the social security and FUTA wage bases is to be made without regard to whether such amounts are treated in regulations as wages for income tax withholding purposes. *This provision thus prevents the application to compensation, other than meals and lodging, of the Supreme Court's reasoning in Rowan Companies, Inc. vs. United States*, 452 U.S. 247 (1981). * * *
>
> The provision in the Amendments applies to remuneration paid after December 31, 1983, for FICA and social security benefit purposes . . . . *Thus, it is possible that this provision could be cited as demonstrating Congressional intent that the reasoning of the Rowan decision should generally apply before these dates to types of remuneration other than meals and lodging* . . . . * * *
>
> *In order to avoid the inferences which this provision could raise*, the bill clarifies the effective date of the provision *overriding the Rowan decision* so that the provision applies for all purposes, other than the treatment of certain employer-provided meals and lodging, both to remuneration paid after March 4, 1983, and to remuneration paid on or before March 4, 1983, which the employer treated as wages when paid. * * *

H.R. Rep. No. 98-432, at 1657-58 (1984) (emphasis added); *see* H.R. Conf. Rep. No. 98-861, at 1414-15 (1984) (containing similar language); *see also* Joint Committee Print, *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, JCS-41-85, at 1231-32 (1984).

It is also noteworthy that the Supreme Court has stated that its holding in *Rowan* was not strictly based on the principle that the same word used in two different statutes or regulations should be interpreted to have the same meaning, but also was informed by Congressional intent. In *Environmental Defense v. Duke Energy Corp.*, 127 S. Ct. 1423 (2007), the same word was used in two Environmental Protection Agency regulations. The Court rejected the argument that *Rowan* requires identical words be interpreted in the same manner. The Court stated:

> Although we ultimately held [in *Rowan*] that the income tax treatment was the proper one across the board, we did not see it this way simply because a "substantially identical" definition of "wages" appeared in each of the different statutory provisions. Instead, we relied on a manifest "congressional concern for the interest of simplicity and ease of administration." The FICA and FUTA regulations fell for failing to "serve that interest," and not for defying definitional identity.

Id. at 1433 (internal citations omitted). The Court stated that "[t]here is, then, no 'effectively irrebuttable' presumption that the same defined term in different provisions of the same statute must 'be interpreted identically.'" *Id.* Instead, the Court instructed, "[c]ontext counts." *Id.* Thus, the Court's discussion in *Environmental Defense* makes clear that

it is appropriate to examine the legislative history and purposes of a statute to determine whether the presumption that the same words are interpreted identically should be given effect. Inasmuch as *Rowan* was based on the Court's interpretation of Congressional intent with respect to FICA tax and income-tax withholding, it is significant that Congress has clarified that its intent was *not* what the Court understood it to be. In continuing to rely on *Rowan* to require consistency between the two definitions of "wages," the courts below disregarded Congress's unambiguous statements that that aspect of *Rowan* was incorrect.

D. *Rowan* has been legislatively overruled

In any event, *Rowan* was legislatively overruled in 1983 by the decoupling provision.[11] As noted above, *Rowan* involved two Treasury regulations that treated meals and lodging provided to employees differently for income-tax withholding and FICA tax purposes. It is hardly surprising, therefore, that the decoupling provision focused on

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[11] We acknowledge that the Federal Circuit in *CSX II* disagreed with this argument. 518 F.3d at 1344-45. The court acknowledged, however, that its decision regarding *Rowan* was not critical to its disposition of the case, inasmuch as the court had rejected the argument that I.R.C. § 3402(o) establishes that SUB pay is not wages. *Id.* at 1345-46.

Treasury regulations. That provision states: "Nothing 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 regulations prescribed for purposes of this chapter." I.R.C. § 3121(a) (flush language). The courts below relied on *CSX I*'s holding that the 1983 amendment was not self-executing and, therefore, absent a regulation expressly delineating—as wages for FICA tax purposes—an item that is not wages for income-tax withholding purposes, *Rowan* controls. While the 1983 amendment did not expressly state that *Rowan* was thereby overruled, the legislative history demonstrates that this was the clear intent of Congress.

According to the House Report, the amendment "[p]rovides that the definition of wages subject to the FICA tax would be interpreted solely with reference to the FICA statute, not with reference to income taxes or income tax withholding." H.R. Rep. No. 25, pt. 1, at 79. After noting the Supreme Court's decision in *Rowan*, the House report explained the purpose of the amendment as follows (*id.* at 80):

> The social security program aims to replace the income of beneficiaries when that income is reduced on account of retirement and disability. Thus, the amount of "wages" is the measure used both to define income which should be replaced and to compute FICA tax liability. Since the social security system has objectives which are significantly different from the objectives underlying the income tax withholding rules, your Committee believes that amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion.
>
> Your Committee's bill provides that, with the exception of the value of meals and lodging provided for the convenience of the employer, the determination whether or not amounts are includible in the social security wages base is to be made without regard to whether such amounts are treated as wages for income tax withholding purposes. Accordingly, an employee's "wages" for social security tax purposes may be different from the employee's "wages" for income tax withholding purposes.

See also S. Rep. No. 98-23, at 42 (1983).

The 1983 amendment should be interpreted with its clear legislative purpose in mind. As the Supreme Court explained in *Bob Jones University v. United States*, 461 U.S. 574, 586 (1983):

> It is a well-established canon of statutory construction that a court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute: "The general words used in the clause . . ., taken by themselves, and literally construed, without regard to the object in view, would seem to sanction the claim of the plaintiff. But this mode of expounding a

> statute has never been adopted by any enlightened tribunal—because it is evident that in many cases it would defeat the object which the Legislature intended to accomplish. And it is well settled that, interpreting a statute, the court will not look merely to a particular clause in which general words may be used, *but will take in connection with it the whole statute . . . and the objects and policy of the law . . ..*" *Brown v. Duchesne*, 19 How. 183, 194, 15 L. Ed. 595 (1857) (emphasis added).

See Consumer Product Safety Commission v. GTE Sylvania, 447 U.S. 102, 108 (1980) (the language of a statute controls "[a]bsent a clearly expressed legislative intention to the contrary"); *United States v. Shafer*, 573 F.3d 267, 278 (6th Cir. 2009) (applying this principle and stating, "where the text of a statute conflicts with the statute's clear purpose, the natural reading of the statute is properly informed by the underlying purpose and the overall framework of the Act"). As discussed above, the legislative history of the 1983 amendment makes it unmistakably clear that Congress intended to abolish any presumed parity of meaning of the term "wages" in the income-tax withholding and FICA provisions, and intended that the determination whether amounts constitute FICA wages be made independently of whether the amounts are treated as wages under the withholding provisions.

A number of courts, relying on the clear intent of Congress as detailed in the legislative history, have concluded that the decoupling amendment "overruled the broad holding of *Rowan*," *Temple University v. United States*, 769 F.2d 126, 133, 135 (3d Cir. 1985), and "overturned the general premise of *Rowan* by enacting provisions that 'decoupled' the interpretations of FICA . . . wages from the interpretation of wages for income-tax purposes," *Canisius College v. United States*, 799 F.2d 18, 21 (2d Cir. 1986). *See also New England Baptist Hospital v. United States*, 807 F.2d 280, 284 (1st Cir. 1986) ("Congress had the broader purpose of precluding claims for FICA tax refunds based on *Rowan*); *STA of Baltimore-ILA Container Royalty Fund v. United States*, 621 F. Supp. 1567, 1575 (D. Md. 1985) ("By overriding the *Rowan* decision, Congress has now made it clear that the definition of wages for purposes of income tax withholding is not the same as the definition of wages under FICA"), *aff'd,* 804 F.2d 296 (4th Cir. 1986) ("we find ourselves persuaded by the thorough and sound analysis of the district court" and accordingly "affirm for the reasons expressed by the district court"); *Robert Morris College v. United States*, 11 Cl. Ct. 546, 550-51 (1987).

That Congress intended to overrule *Rowan* was further made clear when, as discussed above, Congress made the decoupling provision retroactive. As the Third Circuit explained in *Temple University*, 769 F.2d at 131-32 (emphasis in original), "[b]y making the change retroactive, there can be no doubt that Congress intended to cut off *all* claims to refunds based on the rationale of *Rowan*, i.e., that 'wages' for FICA purposes are presumptively the same as 'wages' for income tax withholding purposes." *See also Canisius College*, 799 F.2d at 23-25; *New England Baptist Hospital,* 807 F.2d at 284; *Robert Morris College*, 11 Cl. Ct. at 551-52.

Finally, *Rowan* interpreted the statutory scheme as it existed during the 1967 through 1969 years in issue in that case, not as it existed during the 1999 through 2002 years in issue in the present case. In *Rowan*, the Supreme Court thought that "[i]t would be extraordinary for a Congress pursuing th[e] interest [of promoting simplicity and ease of administration] to intend, *without ever saying so*, for identical definitions to be interpreted differently." 452 U.S. at 257 (emphasis added). But Congress has now "said so." Unlike the statutory scheme as it existed prior to 1983, the statutory scheme after

1983 contains a provision that specifically permits the term "wages" to be defined differently in regulations under the income-tax withholding and FICA tax provisions of the Code. I.R.C. § 3121(a) (flush language). At the very least, this provision indicates that the term "wages" does not inherently have the same meaning in both contexts.

In sum, nothing in I.R.C. § 3402(o) should disturb the fact that the severance payments at issue clearly constitute wages under I.R.C. § 3121 and this Court's precedents. As the Federal Circuit correctly held in *CSX II*, I.R.C. § 3402(o) does not establish that SUB pay is not wages. And even if it did, *Rowan* no longer provides a basis for extending that interpretation to the FICA context.

E. The District Court's policy rationale was misplaced

In affirming the Bankruptcy Court's ruling, the District Court opined that the "collection of social benefit taxes" on the severance payments at issue "makes little sense" because it viewed the payments as "intended to serve the same purpose as social security benefits, i.e., support for workers in lieu of a lost ability to earn wages." (RE 13, Dist. Op. 12.) The court stated that "at some point a line is to be drawn

on the taxation of employee financial benefits; otherwise, the benefits become the basis of the very taxes collected to return as benefits." (*Id.*) The District Court, however, was wrong to conclude that social security benefits and severance payments serve the same purpose. And in any event, it is Congress's province—not the courts'—to determine where the "line is to be drawn."

First, the District Court's view that the severance payments at issue were wage-replacement social benefits in the manner of social security payments misses the mark. As excepted by Rev. Rul. 90-72, for example, SUB pay does approximate additional unemployment insurance, *i.e.*, wage-replacement benefits. But the severance payments at issue were not so narrowly tailored. They were paid not only to unemployed individuals, but also to individuals not suffering a wage loss, *i.e.*, to those individuals who found employment shortly after being terminated. Moreover, the purpose of social security is to provide funds to workers who can no longer work due to advanced age or disability. *See Nierotko*, 327 U.S. at 364; *Detroit Medical Center*, 557 F.3d at 415. The severance payments at issue were paid without regard to such factors. Therefore, the District Court was wrong in

concluding that the severance payments at issue approximate social security benefits.

In any event, it was not the court's role to decide such policy matters. Rather, such policy choices are the sole province of Congress. When Congress decided to subject dismissal pay to FICA tax in 1950, it presumably weighed the considerations laid out by the District Court and nevertheless decided that dismissal pay should be included in the social security wage base. The District Court was not free to rewrite that policy choice.

CONCLUSION

Based on the foregoing, this Court should reverse the judgments below.

Respectfully submitted,

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Dated: July 13, 2010

ADDENDA

DESIGNATION OF RELEVANT DISTRICT COURT DOCUMENTS CONTAINED IN THE ELECTRONIC RECORD

Record Entry No.	Description of Document
1, #27	Complaint
1, #20	Joint Stipulation of Undisputed Facts
1, #18	Government's Motion for Summary Judgment
1, #19	Debtors' Cross-Motion for Summary Judgment
1, #15	Government's Opposition to Debtors' Motion for Summary Judgment
1, #16	Debtors' Opposition to Government's Motion for Summary Judgment
1, #13	Bankruptcy Court's Opinion
1, #11	Government's Motion for Reconsideration
1, #10	Bankruptcy Court's Order on Reconsideration
1, #6	Bankruptcy Court's Judgment
1, #1	Government's Notice of Appeal to District Court
7	Government's Opening Brief in District Court
8	Debtors' Answering Brief in District Court
11	Government's Reply Brief in District Court

DESIGNATION OF RELEVANT DISTRICT COURT DOCUMENTS
CONTAINED IN THE ELECTRONIC RECORD
(continued)

Record Entry No.	Description of Document
13	District Court's Opinion
14	District Court's Order Affirming Bankruptcy Court
17	Government's Notice of Appeal to Sixth Circuit
1, #14	Transcript of 11/15/06 Hearing before the Bankruptcy Court on Motions for Summary Judgment

STATUTORY ADDENDUM

Internal Revenue Code (26 U.S.C.)

Sec. 3121. Definitions.

(a) Wages. For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; * * *.

Nothing 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 regulations prescribed for purposes of this chapter.

* * *

(b) Employment. For purposes of this chapter, the term "employment" means any service, of whatever nature, performed [ ] by an employee for the person employing him * * *.

* * *

Sec. 3402. Income tax collected at source

* * *

(o) Extension of withholding to certain payments other than wages.

(1) General rule. For purposes of this chapter (and so much of subtitle F as relates to this chapter)–

(A) any supplemental unemployment compensation benefit paid to an individual,

(B) any payment of an annuity to an individual, if at the time the payment is made a request that such annuity be subject to withholding under this chapter is in effect, and

(C) any payment to an individual of sick pay which does not constitute wages (determined without regard to this subsection), if at the time the payment is made a request that such sick pay be subject to withholding under this chapter is in effect,

shall be treated as if it were a payment of wages by an employer to an employee for a payroll period.

(2) Definitions.

(A) Supplemental unemployment compensation benefits. For purposes of paragraph (1), the term "supplemental unemployment compensation benefits" means amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (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, but only to the extent such benefits are includible in the employee's gross income.

* * *

CERTIFICATE OF SERVICE

It is hereby certified that on July 13, 2010, the foregoing brief was electronically filed with the Clerk of the Court by using the ECF system. Counsel for the appellees are registered ECF users and will be served by the ECF system.

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