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

REPLY BRIEF FOR THE APPELLANT

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This reply brief is directed only to those portions of the Debtors' brief and the amicus briefs of the ERISA Industry Committee ("ERIC") and the American Payroll Association ("APA") that we believe warrant a response. With respect to points not addressed, we rely on our opening brief.

The issue in this case is whether severance payments paid by Debtors, Quality Stores, Inc. and its affiliates, constituted "wages" subject to Federal Insurance Contributions Act ("FICA") tax. In our opening brief, we argued that the courts below erred by failing to consider this question under the relevant FICA statute, I.R.C. § 3121 (26 U.S.C.). We explained that the definition of wages in I.R.C. § 3121 is to be broadly construed, a point which Debtors concede (Br. 14-15). We observed that I.R.C. § 3121 does not contain a specific exclusion for severance pay, though the Internal Revenue Service ("IRS"), through a series of Revenue Rulings, has carved out a limited exception for certain supplemental unemployment compensation benefits that meet the criteria set forth in the rulings. (There is no dispute that the severance payments at issue do not qualify for exclusion under the Revenue Rulings.) Moreover, we pointed out that I.R.C. § 3121 contained an exclusion for "dismissal pay" prior to 1950, and we argued that the repeal of the exclusion evidences Congress's intent to subject dismissal pay to FICA tax. We also examined decisions of this Court that have construed I.R.C. § 3121's definition of "wages," and we argued

that the severance payments at issue qualified as wages under those precedents.

We further argued that the courts below erred in relying on I.R.C. § 3402(o), an income-tax withholding statute, to determine whether the severance payments at issue were wages for FICA tax purposes. We pointed out that the plain language of I.R.C. § 3402(o) limits its applicability to income-tax withholding, and we argued that the section's reach accordingly should not be extended to FICA tax. We also argued that the courts erred in interpreting I.R.C. § 3402(o)(1) as establishing that all supplemental unemployment compensation benefits (or "SUB pay") are not "wages" in the first instance, and we noted that this ruling is in direct conflict with the Federal Circuit's decision in *CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008) ("*CSX II*").[1]

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[1] In this regard, we note that the APA has misstated the issue in this case, as well as the Government's position. The APA states that the "parties agree that SUB-Pay is not taxable wages for FICA purposes" and that "it is undisputed that SUB-Pay is not remuneration for services." It argues that the sole question is "how to define SUB-Pay." (APA Br. 2, 5.) This is not so. As stated above, the Government's position is that only SUB pay as defined in the pertinent

(continued...)

Finally, we argued that, even if I.R.C. § 3402(o)(1) establishes that SUB pay is not wages for income-tax withholding purposes, that interpretation should not be carried over to the FICA context. We criticized the courts' reliance on *Rowan Cos. v. United States*, 452 U.S. 247 (1981), arguing that it was not properly applied here if still relevant, and that, in any event, it was overruled by the decoupling provision.

1. Debtors incorrectly argue that the repeal of the FICA tax exclusion for "dismissal pay" is irrelevant

Debtors and amici contend that Congress's treatment of dismissal pay is not relevant to this case, and Debtors criticize the Government's discussion of dismissal pay as "*flatly wrong*." (Debtors Br. 27 (emphasis in original), 31; APA Br. 27.) First, Debtors claim that our statement that "[p]rior to 1950, 'dismissal pay' was specifically excluded from

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[1](...continued)
Revenue Rulings is not wages for FICA tax purposes. SUB pay, as more broadly defined in I.R.C. § 3402(o), that does not meet the requirements of the Revenue Rulings does constitute wages. This is precisely what the Federal Circuit held in *CSX II*. It rejected the argument that all SUB pay is not wages by virtue of I.R.C. § 3402(o), 518 F.3d at 1333-45, and it went on to rule that the payments at issue were wages under I.R.C. § 3121, *id.* at 1345-50. We also do not agree with the bullet points of "likely" agreement at APA Br. 5-6.

FICA's definition of wages" is wrong because we failed to clarify that "only a small category of dismissal payments . . . was excluded." (Debtors Br. 27.) This distinction is of no moment, and in fact it detracts from Debtors' case. As Debtors explain it, most dismissal pay was *not* excluded from FICA's definition of wages, which means that dismissal pay generally constituted wages.[2]

In any event, the repeal of the exclusion for dismissal pay is highly relevant in this case because had the exclusion not been repealed, there likely would be no present controversy. The exclusion for dismissal pay was added to the Internal Revenue Code in 1939 and provided that: "The term 'wages' means all remuneration for

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[2] Debtors also erroneously state that "the Government's entire argument regarding the treatment of 'dismissal pay' as wages for FICA tax purposes is premised largely upon a Treasury Regulation that was promulgated by the IRS to implement the *income tax withholding provisions*." (Debtors Br. 18, n.8 (emphasis in original) & Br. 28, n.13.) On the contrary, we did not refer to or cite such regulation (*i.e.,* 26 C.F.R. (Treas. Reg.) § 31.3401(a)-1(b)(4)) anywhere in the Argument section of our brief. Debtors further contend that in Rev. Rul. 71-408, 1971-2 C.B. 340, the IRS relied on the regulation in analyzing whether certain severance payments were subject to FICA tax, but that is not the case. (Br. 18, n.8.) The ruling also addressed whether the payments were subject to income-tax withholding, and the regulation was cited in that context.

employment . . . except that such term shall not include . . . [d]ismissal payments which the employer is not legally required to make." *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). The legislative history states that section 1426, as amended, "continues the present definition of wages, but excludes certain payments heretofore included." H.R. Rep. 76-728, at 59 (1939); *see* S. Rep. No. 76-734, at 73 (1939). Had this exclusion remained part of the Code, Debtors' severance payments probably would have been excluded from FICA tax because there is no indication that Debtors were legally required to make such payments.

But Congress repealed the exclusion in 1950, and in doing so, it expressly stated that, "[t]herefore, a dismissal payment, which is any payment made on account of involuntary separation of the employee from the service of the employer, *will constitute wages* . . . irrespective of whether the employer is, or is not, required to make such payment." H.R. Rep. No. 81-1300, at 124 (1949) (emphasis added). Contrary to Debtors' contention (Br. 28), Congress clearly indicated that dismissal payments would be "automatically included in the definition of wages

under FICA," as they were prior to 1939.[3] The severance payments at issue were "made on account of involuntary separation of the employee from the service of the employer," and, thus, are precisely the type of payments that Congress intended to subject to FICA tax.

Debtors are incorrect in stating (Br. 28) that "both before and after the 1950 Amendment, whether dismissal payments constitute wages for purposes of FICA in a particular case depends on whether the payments are determined to be 'remuneration for any service performed by an employee' based on a factual review." Once the exclusion was added in 1939, any dismissal payment that qualified under the statute was excluded from the definition of wages, regardless of whether it was, as a technical matter, remuneration for services. That was the entire purpose of the exclusion. And if the repeal of the exclusion is to have any meaningful effect, then dismissal pay must now be included in the definition of wages. *See, e.g., Murphy v. IRS*,

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[3] The 1936 Treasury regulations cited by Debtors and attached to their brief show that, prior to 1939, dismissal pay was specifically included in the definition of wages for FICA tax purposes. (Debtors Br. 28 & Addendum C-4 at 13). Treas. Reg. 90, Art. 209(b) (1936) ("Payment to an employee of so-called dismissal wages . . . constitutes wages.").

493 F.3d 170, 179-80 (D.C. Cir. 2007) (narrowing of I.R.C. § 104(a), which excluded from income damages for personal injuries, resulted in damages for non-physical personal injuries being included in income). As the Federal Circuit stated in *CSX II*, "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." 518 F.3d at 1334.

In an attempt to distinguish the severance payments at issue from dismissal pay, Debtors and amici contend that "'[d]ismissal payments' and 'SUB payments' are not synonymous." (Debtors Br. 29-31; *see* APA Br. 4-5, 27-29.) But SUB pay clearly is a subset of dismissal pay. Dismissal pay is defined as any payment made "on account of involuntary separation of the employee from the service of the employer." H.R. Rep. No. 81-1300, at 124; *see also* Treas. Reg. § 31.3401(a)-1(b)(4) (defining dismissal pay for income-tax withholding purposes). SUB pay is "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[.]" I.R.C. § 3402(o)(2)(A). SUB pay is thus a specific type of dismissal pay. The APA claims (Br. 4-5) that dismissal pay refers only to payments made when an employee is terminated for cause, but the definition of dismissal pay set forth above plainly does not support that distinction. In short, though not all dismissal pay is SUB pay, all SUB pay is dismissal pay. *See CSX II*, 518 F.3d at 1338-39 (rejecting taxpayer's attempt to distinguish SUB pay from dismissal pay).

Debtors also argue (Br. 31) that Congress must not have intended to subject all dismissal pay to FICA tax as a result of the 1950 amendment because, if so, the IRS would not have excluded SUB pay meeting the requirements of the Revenue Rulings from FICA tax beginning in 1956. The issue of SUB pay, however, arose after the 1950 repeal of the exclusion for dismissal pay. As explained by the Federal Circuit:

> In the mid-1950s, several large American industrial employers adopted plans pursuant to collective bargaining under which the employers agreed to fund trusts that would supplement state unemployment compensation for employees who were laid off. Those payments, denominated SUB payments, depended for their effectiveness in part on their not being characterized as "wages." That was because

> unemployment benefits in a number of states were not available to employees who were earning "wages" from their employers, and the employees' loss of state unemployment benefits would largely defeat the purpose of the supplemental unemployment benefits. Accordingly, those who adopted such SUB plans sought to ensure that the payments from those plans would not have the legal status of "wages." . . . .

CSX II, 518 F.3d at 1334-35 (internal citations omitted); *see also* S. Rep. No. 86-1518, at 2 (1960) & H.R. Rep. No. 86-1145, at 3-4 (1959) (discussing the history of SUB pay in the context of enacting I.R.C. § 501(c)(17), which provides an income-tax exemption for certain SUB trusts). In 1956, the IRS began examining SUB plans and issued numerous Revenue Rulings indicating when SUB pay would, and would not, be considered wages. *See CSX II*, 518 F.3d at 1335-36; Rev. Rul. 90-72, 1990-2 C.B. 211.

While one could argue (as ERIC has, Br. 20) that the IRS lacked authority to carve out an exclusion for SUB pay meeting the requirements of the Revenue Rulings in light of Congress's treatment of dismissal pay, taxpayers obviously have not clamored to do so inasmuch as the exclusion lowers their tax burden. Moreover, Congress clearly was aware of the IRS's treatment of SUB pay meeting

the requirements of the Revenue Rulings when it enacted the tax exemption for SUB trusts in 1960 and when it subjected SUB pay to income-tax withholding in 1969. *See* Gov. Br. 39-40 and pp. 13-15, *infra*. But Congress has not taken any steps to undo the IRS's limited exclusion of SUB pay from FICA tax.

2. Debtors rely heavily on legislative history for the proposition that SUB pay is not wages, but they fail to grasp that the legislative history was referring to the IRS's Revenue Rulings regarding SUB pay

Throughout their brief, Debtors point to the 1969 Senate Finance Committee Report that accompanied the enactment of I.R.C. § 3402(o) as establishing that SUB pay is not wages. Indeed, all of their arguments can be traced back to this fundamental point. (Debtors' Br. 19-21, 25, 33, 39, 49, 51.) Debtors fail to come to terms, however, with the fact that the Committee Report was merely reciting "present law," and the source of that "present law" was the very IRS Revenue Rulings that Debtors disavow. (Debtors do concede, however, that "[w]hen Congress enacted Code § 3402(o) in 1969, it can be reasonably assumed that Congress was aware of these rulings." (Br. 54.)) The Committee Report does not purport to legislate whether SUB pay is wages in the

first instance. Rather, it merely explains that under then-existing law (*i.e.* Rev. Rul. 56-249, 1956-1 C.B. 488; 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), SUB pay was not subject to withholding (because it was not considered wages or remuneration for services), and it explains the reasons for subjecting SUB pay to income-tax withholding. Debtors argue (Br. 21) that this "interpretation, however, does not explain the Committee Report's statement that SUB payments were not considered 'remuneration for services,'" but that phrase merely restates the statutory definition of wages for income-tax withholding purposes. *See* I.R.C. § 3401(a). Debtors fail to cite to any other authority that would have supplied the "present law" referred to by the Senate Finance Committee, and there is none.[4]

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[4] The APA contends (Br. 11) that "present law" referred to I.R.C. § 501(c)(17), but that section has nothing to do with FICA or withholding. ERIC contends (Br. 6, 18) that the Supreme Court acknowledged that SUB pay was excluded from wages in *Rudolph v. United States*, 370 U.S. 269, 274 n.7 (1962), but it fails to point out that the Supreme Court cited to Rev. Rul. 56-249 for that proposition. And Debtors cite to *CSX II* as recognizing that "[d]uring the 1960's, SUB payments were treated, for income tax purposes, as ordinary income to the recipient, but not as wages for purposes of either the income tax

(continued...)

Moreover, the legislative history of I.R.C. § 501(c)(17) shows that, in enacting the provision, Congress had the IRS Revenue Rulings in mind. As Debtors point out (Br. 20), the enactment of I.R.C. § 501(c)(17) preceded the enactment of I.R.C. § 3402(o), and the definition of SUB pay in the latter section tracks the definition in I.R.C. § 501(c)(17). The 1960 Senate Finance Committee report accompanying I.R.C. § 501(c)(17) explains the history of SUB pay as follows:

> The first of the main SUB plans were those negotiated with the automobile industry in 1955. The bulk of the plans developed since that time have followed the same general pattern. Under the automobile industry plans a worker is eligible for a SUB payments if he is laid off by the company either as a reduction in force or in a temporary layoff. Usually these payments also depend upon the concurrent receipt (at least during part of the period) of State unemployment benefits. . . . .
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> * * *
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> Most of the plans are set up as separate trusts and are funded by payments by the employer to the trusts of something like 3 to 5 cents per hour per employee. *Various rulings of the Internal Revenue Service have held that the*

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[4](...continued)
withholding statutes or FICA" (Br. 20, 21-22, *quoting CSX II*, 518 F.3d at 1336), but they too fail to appreciate that that treatment was a result of the Revenue Rulings, as the Federal Circuit explained in its opinion.

> *contributions to these funds are deductible to the employers and distributions from these funds are taxable to the recipients as income (although not generally subject to withholding).*

S. Rep. No. 86-1518, at 2 (emphasis added); *see* H.R. Rep. No. 86-1145, at 3-4. The APA is thus wrong in stating (Br. 11) that there is a "total absence of any direct or indirect Congressional reference to any IRS rulings."

Other portions of the legislative history of I.R.C. § 3402(o) show that the recommendation that SUB pay be subjected to income-tax withholding was made by the Treasury Department. *See* Tax Reform Act of 1969, Compilation of Decisions Reached in Executive Session, Senate Finance Committee Print, 91st Cong., 1st Sess. at 80 (Oct. 31, 1969) ("The Committee also adopted a Treasury recommendation that supplemental unemployment benefits (SUB payments) be subject to withholding."). Considering that the proposal originated with the Treasury, it is clear that I.R.C. § 3402(o) was focused on the SUB pay that Treasury had excepted from FICA and income-tax withholding in

its earlier Revenue Rulings, though the provision's reach ultimately was broader.[5]

Finally, ERIC's argument (Br. 16-18) that Congress ratified the IRS's position stated in Rev. Rul. 77-347, 1977-2 C.B. 362 (which was revoked by Rev. Rul. 90-72) when it overhauled the Internal Revenue Code in 1986 is meritless. I.R.C. § 3402(o) was enacted in 1969, and there is no indication that Congress has revisited the SUB pay portions of the provision since that time. In fact, I.R.C. § 3402(o)(1) and (2) have remained unchanged since at least 1982. *See* I.R.C. § 3402(o) (1982). As we have argued, Congress was aware of the IRS's administrative practice with respect to SUB pay in the 1960s, when it enacted I.R.C. §§ 501(c)(17) and 3402(o), and, at that time, all of the IRS's rulings regarding SUB pay consistently followed Rev. Rul. 56-249. Indeed, ERIC concedes elsewhere in its brief (p.23) that "[a]t the time that

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[5] As the Federal Circuit explained in *CSX II*, it is not problematic here that Congress drafted I.R.C. § 3402(o) with a reach broader than the specific problem that triggered the legislation. 518 F.3d at 1340-41; *see, e.g., Henry E. & Nancy Horton Bartels Trust v. United States*, 209 F.3d 147, 153-54 (2d Cir. 2000); *Henry E. & Nancy Horton Bartels Trust v. United States*, _ F.3d _, 2010 WL 3464586, *4 (Fed. Cir. Sept. 7, 2010).

I.R.C. § 3402(o) was enacted (1969), it was clear that there was a single, consistent definition of SUB payments," citing to Rev. Rul. 56-249.

3. Debtors' statutory interpretation argument ignores the prefatory language of I.R.C. § 3402(o) that limits its applicability to income-tax withholding

Debtors and amici urge this Court to give effect to what they deem to be the plain language of I.R.C. § 3402(o), which, Debtors contend, "makes it clear that . . . *all* payments constituting SUB payments as defined therein constitute nonwages." (Debtors Br. 22; *see* ERIC Br. 10-11.) Noticeably absent from their statutory-interpretation argument, however, is any reference to the prefatory language of I.R.C. § 3402(o)(1), which states that the subsection applies only "[f]or purposes of this chapter [24] (and so much of subtitle F as relates to this chapter)." Therefore, any inference that could be drawn from I.R.C. § 3402(o)—specifically, the inference that SUB pay is not wages—is limited to the income-tax withholding provisions of the Code. Debtors, amici, and the courts below conveniently ignore this statutory limitation. For example, after arguing that I.R.C. § 3402(o) makes "clear that all payments that qualify as SUB payments . . . are

nonwages," Debtors state that "[t]he only issue is whether the Severance Payments constitute nonwages not only for purposes of income tax withholding (Chapter 24 of the Code) but also for purpose of FICA taxation (Chapter 21 of the Code)." (Debtors Br. 25.) The answer lies in the prefatory language of I.R.C. § 3402(o)(1), which limits its applicability to chapter 24.[6]

Debtors also point out (Br. 16) that the heading of I.R.C. § 3402(o) refers to income-tax withholding for "certain payments other than wages," but as a matter of statutory construction, no inference may be drawn from the heading. *See* I.R.C. § 7806(b) ("No inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion of this title, nor shall any table of contents, table of cross references, or similar outline, analysis, or descriptive matter

[6] In this regard, we disagree with the APA's suggestion (Br. 5) that all of the employment taxes contained in chapters 21 through 25 of the Code can be lumped together as one category of taxes for all purposes. As explained on pp. 47-49 & n.10 of our opening brief, FICA-tax withholding is qualitatively different from income-tax withholding. Congress emphasized this point in the legislative history of the decoupling amendment. *See* Gov. Br. 54.

relating to the contents of this title be given any legal effect."); *Alcoa, Inc. v. United States*, 509 F.3d 173, 181 n.7 (3d Cir. 2007); *Grapevine Imports, Ltd. v. United States*, 71 Fed. Cl. 324, 331 (2006); *Brown-Forman Corp. v. Commissioner*, 94 T.C. 919, 943 (1990).

Debtors and amici criticize the Government's interpretation of I.R.C. § 3402(o) on the basis that it purportedly would make the "shall be treated" language of I.R.C. § 3402(o)(1) superfluous. (Debtors Br. 49; ERIC Br. 12-13.) But as the Federal Circuit recognized in *CSX II*, 518 F.3d at 1342, our interpretation does not render the "shall be treated" language superfluous because the SUB pay described in the IRS Revenue Rulings does not constitute wages. Thus, the "shall be treated" language is necessary to subject those types of SUB pay to income-tax withholding. Moreover, Debtors candidly concede that under their interpretation, some statutory language is, in fact, rendered superfluous. In footnote 12 of their brief, Debtors state that "the exclusion of sick pay under § 3121(a) was arguably unnecessary" because, in their view, I.R.C. § 3402(o) already established that "sick

pay is not considered wages," referring to this overlap as a "redundancy in the statute."[7]

If, as Debtors contend (Br. 24), Congress intended I.R.C. § 3402(o)(1) to be the means by which SUB pay would be excluded from FICA tax, it could not have chosen a more roundabout way to do so. I.R.C. § 3402(o) is an *income* tax withholding statute that, by its own terms, applies only to the income-tax withholding provisions of the Code. It is only by virtue of *Rowan*, decided fourteen years after I.R.C. § 3402(o) was enacted, that there is even a basis for extending I.R.C. § 3402(o) to the FICA tax context. (And, as discussed in our opening brief (pp. 46-52), Congress immediately expressed its disagreement with *Rowan*.) Moreover, I.R.C. § 3402(o) does not state outright that SUB pay is not wages. Considering that "exemptions from taxation . . . do not rest upon implication, but must be unambiguously proved," *United States v. Detroit Medical Center*, 557 F.3d 412, 414-15 (6th Cir. 2009) (citations & quotations omitted), the courts' circuitous rationale

[7] We take issue with Debtors' suggestion that the exclusion from FICA tax for sick pay is more properly placed among the income-tax withholding provisions of I.R.C. § 3402(o), rather than the FICA tax provisions of I.R.C. § 3121.

for excluding all SUB pay from FICA tax, which hinges on the fortuitous intervention of *Rowan*, should be rejected.

Even more convoluted is the APA's argument that the IRS's 1968 information-reporting regulations establish that SUB pay is not wages for FICA tax purposes. (APA Br. 7-8, 9, 11-12, 31.) According to the APA, the regulations required tax-exempt SUB trusts to report their payments to recipients using a Form 1099, rather than a Form W-2. The APA reasons that because the Form W-2 is generally used to report wages, the SUB trusts' payments must not have constituted wages. The APA then infers that the IRS must not have viewed SUB pay as wages for FICA tax purposes, and that Congress shared that view. A more ambiguous and indirect way of legislating the FICA tax treatment of SUB pay is hard to imagine. In any event, the legislative history of I.R.C. § 501(c)(17) shows that, to the extent Congress believed that SUB pay did not constitute wages, that view was based on "[v]arious rulings of the Internal Revenue Service." *See* pp. 13-14, *supra*. The

IRS's reporting regulations under I.R.C. § 501(c)(17) simply are not a basis for inferring that Congress has exempted all SUB pay from FICA tax.[8]

In short, this Court should reject the invitation to read into I.R.C. § 3121 a wholesale exclusion for SUB pay that plainly is not there.

4. *Rowan* does not provide a sound basis for extending I.R.C. § 3402(o) to the FICA tax context

In *Rowan*, the Supreme Court held that the definitions of wages for FICA tax purposes and income-tax withholding purposes should be the same in light of Congress's apparent desire to "promote simplicity and ease of administration." 452 U.S. at 257. In our opening brief (pp. 44-46), we argued that the judgment of the courts below distorts *Rowan* because their judgment results in SUB pay being treated differently for

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[8] Many of amici's arguments focus on Treasury regulations and administrative decisions to discern what the IRS purportedly thought about the FICA tax treatment of SUB pay. (*See* APA Br. 7, 9, 11-12, 15, 18-20; ERIC Br. 5, n.3, Br. 19.) But there is no mystery as to the IRS's view. Rev. Rul. 90-72 explicitly addresses the FICA tax treatment of SUB pay and plainly states that "[f]or FICA . . . purposes, SUB pay is defined solely through a series of administrative pronouncements published by the Service." The ruling also makes clear the IRS's view that I.R.C. § 3402(o) plays no role in determining whether SUB pay is wages for FICA tax purposes.

FICA tax purposes than for income-tax withholding purposes. 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.

In response, Debtors argue (Br. 35) that our position would make the statutory scheme "unworkable" because it would make the term "'wages' devoid of any logical meaning or definition." Debtors' argument, however, is based on the false premise that "the Government's position [is] that SUB payments are not 'wages' for income tax withholding purposes." (*Id.*) That is not our position; indeed, that is Debtors' position. Debtors also contend that the Government "misses the point" (*id.*), but it is Debtors who miss the point. They state (Br. 36) that "[t]reating SUB pay as nonwages for both FICA tax and income tax withholding purposes is completely consistent," but the import of I.R.C. § 3402(o) is to treat SUB pay as wages for 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) also 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.

Debtors also argue that *Rowan* remains good law, stating that this Court, in *Gerbec v. United States*, 164 F.3d 1015, 1026 n.14 (6th Cir. 1999), "specifically cited to *Rowan* and acknowledged its continuing vitality." (Debtors Br. 40; *see* ERIC Br. 15, 23.) But the continuing vitality of *Rowan* was not an issue in *Gerbec*, nor was it central to the decision, as it is in this case. Debtors and amici also criticize the four circuit court decisions holding that the decoupling amendment overruled *Rowan* because those courts focused on the legislative history of the decoupling amendment, not just the plain language. (Debtors Br. 39-40; ERIC Br. 21-22.) But as we stated in our opening brief (p.54), "[i]t 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." *Bob Jones University v. United States*, 461 U.S. 574, 586 (1983). Indeed, Debtors have not responded at all to our argument that the legislative history of the decoupling amendment clearly evinces an intent to overrule *Rowan* (Gov. Br. 46-50, 53-54), and no serious challenge can be made. Debtors also make no response to our argument (Gov. Br. 57-58) that, at the very least, the decoupling amendment changed the landscape of the statutory text such that a court could now infer that Congress did not intend "wages" to have substantially identical meanings in both the FICA tax and income-tax withholding contexts.

5. Debtors' remaining arguments are unpersuasive

In our opening brief, we argued that the courts below erred by failing to analyze whether the severance payments at issue were wages under the FICA tax statute, I.R.C. § 3121, and this Court's decisions in *Appoloni v. United States*, 450 F.3d 185 (6th Cir. 2006), and *Sheet Metal Workers Local 141 Supp. Unemp. Benefit Trust v. United States*, 64 F.3d 245 (6th Cir. 1995). (Gov. Br. 26-37.) Debtors call this argument "unfounded," alleging that the courts considered the definition of wages in I.R.C. § 3121 and determined that it should be

interpreted by reference to the income-tax withholding provisions. (Debtors Br. 17.) But this proves our point: as Debtors admit, the courts below skirted the analysis under I.R.C. § 3121 in favor of an analysis under I.R.C. § 3402(o).

As for whether the severance payments qualified as wages under I.R.C. § 3121, Debtors, relying on the legislative history (incorrectly, as discussed above), state that "SUB payments are not wages for income tax withholding purposes because they are not 'remuneration for services' and they do not constitute wages for FICA taxation purposes because they are not 'remuneration for service performed by the employee.'" (Debtors Br. 17.) As explained in our opening brief (at pp. 35-37), the severance payments clearly were wages under I.R.C. § 3121 and the criteria set forth by this Court. The fact that they were not paid in exchange for specific services is not determinative. Indeed, Debtors' contention would eviscerate the holding of *Social Sec. Bd v. Nierotko*, 327 U.S. 358, 364 (1946), which held that back pay awarded to an employee who had been wrongfully discharged qualified as wages for FICA purposes, even though the pay was attributable to periods in which the worker performed no services. (*See* Gov. Br. 27-29.) The

Supreme Court emphasized that remuneration for services encompasses "the entire employer-employee relationship for which compensation is paid." 327 U.S. at 365-66. *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.")

Debtors also attempt to distinguish *Appoloni* and *Sheet Metal Workers* on the basis that those cases did not address SUB pay. (Debtors Br. 43-44, 46.) While that may be so, Debtors cannot escape the fact that in those cases, this Court laid down the criteria for determining when a payment constitutes wages within the meaning of I.R.C. § 3121 and, as a result, those cases are directly applicable here. Debtors apparently concede that if this Court were to apply the criteria set forth in those cases (*e.g.,* seniority, length of service, base pay), it "would render virtually all SUB payments subject to FICA taxation because virtually all severance plans compute payments, at least to some degree, based upon each employee's employment record." (Debtors Br. 44-45.) This is precisely the case, and it explains why

virtually every court to address the issue has ruled that severance pay constitutes wages for FICA tax purposes. *See* Gov. Br. 31, 34-35.

Debtors also argue (Br. 49) that the courts below correctly declined to follow *CSX II*. They state that the "Federal Circuit's construction [of I.R.C. § 3402(o)] does not square with Congress' apparent belief that most (if not all) SUB payments constitute nonwages," adding that "[t]his is the only way to interpret the legislative history of § 3402(o)." But as we have argued, Debtors' interpretation of the legislative history is misguided. The legislative history's reference to present law was a reference to the IRS's Revenue Rulings. Thus, it is perfectly sensible that "only a limited percentage of SUB payments, i.e. those payments meeting the stringent requirements of Rev. Rul. 90-72 or Rev. Rul. 56-249, would constitute nonwages." (Debtors Br. 49.) This result is not "squarely at odds with the overall design of § 3402(o)," as Debtors contend (*id.*), because the purpose of I.R.C. § 3402(o) was to subject all SUB pay to income-tax withholding. As the Federal Circuit observed, there was no need to delineate nonwage SUB pay from wage SUB pay to accomplish that purpose. *CSX II*, 518 F.3d at 1340.

Finally, Debtors (and amici) argue at length that Rev. Rul. 90-72 and the other Revenue Rulings addressing SUB pay are not entitled to judicial deference (Debtors Br. 52-58; APA Br. 17; ERIC Br. 24-25), but the Government has made no such argument before this Court. In any event, their characterization of the Revenue Rulings as "inconsistent and confusing" is incorrect. (Debtors Br. 52; *see* APA Br. 17-21.) Beginning with Rev. Rul. 56-249, the IRS laid out several criteria that must be present for SUB pay to be excluded from wages, and the later rulings simply built on Rev. Rul. 56-249 by expanding its reach. *See CSX II*, 518 F.3d at 1335-40 (detailing the IRS's treatment of SUB pay from 1956 through 1990). The only Revenue Ruling that was inconsistent was Rev. Rul. 77-347 because it appeared to remove eligibility for state unemployment benefits as a material factor. (The Federal Circuit in *CSX II*, however, opined that the ruling should not be read so broadly. *See* 518 F.3d at 1337-38.) Rev. Rul. 77-347 was revoked by Rev. Rul. 90-72, which "re-establish[ed] the link between SUB pay and state unemployment compensation" originally established in Rev. Rul. 56-249. 1990-2 C.B. at 213.

6. The additional authorities cited by amici, as well as their policy arguments, are not persuasive

Amici cite to numerous legal authorities that either do not assist them or are only tangentially relevant here. In particular, amici rely heavily on *NYSA-ILA Container Royalty Fund v. United States*, 847 F.2d 50, 53 (2d Cir. 1988) (cited at ERIC Br. 19, n.5; APA Br. 15-17, 32), in which the court held that certain payments, which the taxpayer claimed were SUB pay, constituted wages subject to FICA tax. But the court's ruling, which was based in part on the view that "the tax laws must be construed to favor – indeed require – the collection of concededly due tax revenues," *id.*, supports the Government here. Indeed, Debtors undoubtedly understood this as they did not cite the case. The APA contends that the Second Circuit adopted the definition of SUB pay contained in I.R.C. § 501(c)(17) for purposes of all employment taxes set forth in the Code. (APA Br. 16, 32.) But this argument is based on a single paragraph in the court's opinion that summarized the relevant Code provisions without any analysis. 847 F.2d at 51-52. The thrust of the court's opinion was that the payments at issue were wages under I.R.C. § 3121. The court refused to decide

whether it would matter if the payments also met the definition of SUB pay contained in I.R.C. § 501(c)(17), observing that the payments did not meet the definition in any event. *Id.* at 53. *NYSA-ILA Container* simply does not have the far-reaching effect that amici ascribe to it.[9]

Amici also cite to Rev. Rul. 80-124, 1980-1 C.B. 122 (cited at ERIC Br. 19; APA Br. 19-20, 32), in support of their argument that all SUB pay, as defined in I.R.C. § 3402(o), is excluded from wages for FICA tax purposes. It is clear from the ruling, however, which cites to Rev. Rul. 56-249, that whether SUB pay is excluded from FICA tax turns on whether it meets the criteria in the IRS's earlier Revenue Rulings. Again, Debtors did not even cite this Revenue Ruling in their brief.

The APA refers to numerous other Code sections and Treasury regulations in support of its argument that the definition of SUB pay contained in I.R.C. § 3402(o) should apply for FICA tax purposes. It

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[9] Amici point out that in *NYSA-ILA*, the Government stated that wages and SUB pay are "mutually exclusive." (APA Br. 16; ERIC Br. 19.) Though the Government stated (once) in its brief that wages and SUB pay are mutually exclusive, it was referring to the SUB pay described in the IRS's Revenue Rulings. The Government argued at length that the Revenue Rulings establish when SUB pay is excluded from FICA tax and that the payments at issue did not meet those requirements.

points out (Br. 8-9, 22) that the definition of SUB pay under I.R.C. § 501(c)(17) does not require the payee to be unemployed or eligible for state unemployment benefits, but this is irrelevant. I.R.C. § 501(c)(17) serves a different purpose than I.R.C. § 3121. As the Federal Circuit explained in *CSX II*, in enacting I.R.C. § 501(c)(17), "Congress was aware that employers had developed SUB plans in a variety of forms. Because Congress wished to ensure tax-free status for a broad range of trusts . . . it defined SUB benefits broadly, to include a wide range of unemployment benefits as well as benefits for related loss of employment because of sickness or accident." 518 F.3d at 1336. The court explained that "it was desirable to extend tax protection to trusts that provided SUB benefits because those trusts are non-profit in nature and provide worthwhile benefits, but at the same time are not in competition with profitmaking enterprises." *Id.* (citations omitted). That Congress wanted a broad class of SUB trusts to be exempt from income tax does not dictate that it similarly wanted a broad class of SUB payments to be exempt from FICA tax. (Indeed, SUB pay generally is taxable income to the recipient.)

In the same vein, the APA argues (Br. 24-27) that the definition of SUB pay for FICA tax purposes need not be linked to eligibility for state unemployment benefits because, in the extended unemployment compensation context, SUB pay already is linked to state unemployment benefits. This is a red herring. The merits of the linkage requirement of Rev. Rul. 90-72 are not at issue here. In any event, the fact that SUB pay is linked to state unemployment benefits in other contexts has no bearing on the threshold question of how SUB pay should be treated for FICA tax purposes. And, if anything, the fact that SUB pay is linked to eligibility for state unemployment benefits in other contexts suggests that the IRS's linkage in the FICA tax context is both reasonable and feasible.[10]

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[10]Because the APA has improperly framed the issue in this case (*i.e.,* it assumes that the parties "agree that SUB-Pay is exempt from FICA taxes" and focuses on how SUB pay should be defined (Br. 2, 5)), many of its arguments are simply inapposite. If I.R.C. § 3121 provided an exclusion for SUB pay but did not define the term, an argument could be made that the definition contained elsewhere in the Code should apply. But the FICA tax provisions simply make no mention of SUB pay whatsoever. Thus, the relevant inquiry is whether the payments are subject to FICA tax as wages under the general definition in I.R.C. § 3121(a), since they are not excluded under the IRS's Revenue Rulings.

Finally, amici posit various policy reasons for excluding SUB pay as defined in I.R.C. § 3402(o) from wages for FICA tax purposes. (ERIC Br. 7-8, 25-28; APA Br. 4-5, 20-24.) They argue that reliance on the IRS's Revenue Rulings to determine when SUB pay is excluded from FICA tax is unworkable because the criteria for exclusion are not clearly articulated. But taxpayers have been relying on those Revenue Rulings since 1956, and Rev. Rul. 90-72, which the APA calls "controversial" (Br. 20), has been in force for 20 years. Indeed, Debtors relied on them here and correctly determined that the severance payments were subject to FICA tax. Amici also argue that use of the I.R.C. § 3402(o) definition would create uniformity because the FICA tax exclusion would not depend upon state unemployment compensation laws, but that is a policy matter for Congress to decide. Moreover, it is not uncommon for federal tax law to have varied results depending on state law. In the collection context, for example, the extent to which the IRS can seize a taxpayer's property in order to satisfy an unpaid tax liability turns on what property rights the taxpayer has under state law. *See, e.g., Spotts v. United States*, 429

F.3d 248, 251 (6th Cir. 2005). In short, amici's complaints are properly directed to Congress, not to this Court.

CONCLUSION

Based on the foregoing and on the Government's opening brief, this Court should reverse the judgments below.

Respectfully submitted,

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It is hereby certified that on September 27, 2010, the foregoing brief was electronically filed with the Clerk of the Court by using the ECF system. Counsel for the appellees and counsel for the amici curiae are registered ECF users and will be served by the ECF system.

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