No. 12-1408

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

QUALITY STORES, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether severance payments made to employees whose employment was involuntarily terminated are taxable under the Federal Insurance Contributions Act, 26 U.S.C. 3101 *et seq*.

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The Solicitor General, on behalf of the United States, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-30a) is reported at 693 F.3d 605. The opinion of the district court (App., *infra*, 33a-54a) is reported at 424 B.R. 237. The opinion of the bankruptcy court (App., *infra*, 55a-77a) is reported at 383 B.R. 67.

JURISDICTION

The judgment of the court of appeals was entered on September 7, 2012. A petition for rehearing was denied on January 4, 2013 (App., *infra*, 31a-32a). On March 25, 2013, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including May 3, 2013. On April 22, 2013, the Chief Justice fur-

ther extended the time to May 31, 2013. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Relevant statutory and regulatory provisions are reproduced in the appendix to this petition. App., *infra*, 84a-214a.

STATEMENT

1. Social Security and Medicare benefits are financed through taxes collected under the Federal Insurance Contributions Act (FICA or the Act), 26 U.S.C. 3101 *et seq*. FICA taxes are imposed on both employers and employees, and both elements of the tax are imposed on all "wages" paid by an employer or received by an employee "with respect to employment." 26 U.S.C. 3101(a) and (b), 3111(a) and (b). FICA defines "wages" in relevant part as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. 3121(a) (2006 & Supp. V 2011). The Act defines "employment" in turn as "any service, of whatever nature, performed * * * by an employee for the person employing him." 26 U.S.C. 3121(b) (2006 & Supp. V 2011).

Section 3402(*o*) of Title 26 deals with withholding of income tax and is entitled "[e]xtension of withholding to certain payments other than wages." 26 U.S.C. 3402(*o*). The provision states a "[g]eneral rule" that, for purposes of Chapter 24 of Title 26 (dealing with income-tax withholding) and certain related provisions, "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." The term "[s]upplemental unemployment compensation benefits" is defined to mean "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." 26 U.S.C. 3402(*o*)(2)(A).

2. In 2001, respondent Quality Stores, Inc. (Quality Stores) and several affiliated companies entered into bankruptcy proceedings. Both before and after their entry into bankruptcy, respondents terminated thousands of their employees. Those employees received severance payments from respondents pursuant to two separate plans. App., *infra*, 2a-3a. The question presented here is whether those severance payments are taxable as "wages" under FICA.

a. Under the terms of the pre-petition severance plan, any employee who was terminated for general business reasons (like the closing of a store or a plant) received severance pay based on his job grade and management level in the organization. The President and Chief Executive Officer received 18 months of severance pay; senior management executives received 12 months of severance pay; and other managers and employees received one week of severance pay for each full year of service. The amount of the severance pay was equal to the employee's regular salary for the covered period, and respondents made the severance payments on their normal payroll schedule. Under the pre-petition plan, salaried employees received an average of 11.4 weeks of severance pay, while hourly employees received an average of 4.2 weeks of severance pay. App., *infra*, 3a-4a.

The post-petition severance plan was designed to encourage remaining employees to defer their job searches and to dedicate their time and efforts to the company. As a result, to be eligible for severance pay under the post-petition plan, an employee had to complete his last day of service as scheduled by the company. For those employees who did so, company executives received between six and 12 months of severance pay; full-time salaried and hourly employees who had been employed by the company for at least two years received one week of severance pay for every full year of service (up to a maximum of ten weeks for salaried employees and five weeks for hourly employees); and salaried and hourly employees with less than two years of service received one week of severance pay. All of these post-petition severance amounts were paid as a lump sum at the end of an employee's service. Under the post-petition plan, salaried employees received an average of 5.2 weeks of severance pay, while hourly employees received an average of 3.1 weeks of severance pay. App., *infra*, 4a.

b. For federal income-tax purposes, respondents reported the payments as wages on W-2 forms and withheld federal income tax. Respondents also treated the severance payments as taxable under FICA; they withheld and remitted to the Internal Revenue Service (IRS) both the FICA tax that they owed as employers and the FICA tax that their employees owed. In September 2002, however, respondents filed for a refund of approximately $1 million in FICA tax that they had paid as employers and that they had paid on behalf of roughly 1850 employees between late 1999 and mid-2002. Respondents subsequently filed the present adversary proceeding in the bankruptcy court seeking a refund of the $1 million in FICA tax. App., *infra*, 5a-6a.

3. a. The bankruptcy court granted summary judgment to respondents. App., *infra*, 55a-77a. The court's analysis focused not on the relevant FICA provisions, but on 26 U.S.C. 3402(*o*), which addresses the withholding of income tax. Based on the parties' stipulation of certain facts, the bankruptcy court found that the severance payments at issue here fall within Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits." *Id.* at 63a-64a.[1] The court also accepted respondents' argument that "supplemental unemployment compensation benefits," as defined in Section 3402(*o*)(2)(A), "are not wages for income tax withholding purposes, but * * * are merely treated as if they were wages." *Id.* at 63a-64a (emphasis omitted). The bankruptcy court further concluded that Congress intended the definition of "wages" to be the same for purposes of income and FICA tax withholding, and it inferred that because "supplemental unemployment compensation benefits are not wages for purposes of income tax withholding, they are likewise not wages under FICA." *Id.* at 76a-77a (internal quotation marks omitted). The court found support for its conclusion in the decision of the Court of Federal Claims (CFC) in *CSX Corp.* v. *United States*, 52 Fed. Cl. 208 (2002).

b. After the bankruptcy court issued its decision in this case, the Federal Circuit reversed the CFC decision

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[1] The government stipulated that the severance payments at issue resulted from "an employee's involuntary separation from employment, resulting directly from a reduction in force or the discontinuance of a plant or operation." 05-80573-jdg, Doc. No. 21, at 4 (Bankr. W.D. Mich. Aug. 15, 2006). The parties further stipulated that the severance payments at issue were not tied to the receipt of state unemployment compensation and were not attributable to the rendering of any particular services by employees to respondents. See *id.* at 4-5.

on which the bankruptcy court had relied. See *CSX Corp.* v. *United States*, 518 F.3d 1328 (2008). The Federal Circuit held in *CSX Corp.* that the severance payments at issue in that case, which were made in connection with a company's reduction in force, were "wages" subject to FICA taxation. See *id.* at 1352. In light of the Federal Circuit's intervening decision in *CSX Corp.*, the government filed a motion for reconsideration in the present case. The bankruptcy court granted the government's motion but "ratified" its previous opinion and order without explanation. App., *infra*, 78a-80a.

4. The district court affirmed. App., *infra*, 33a-54a. The court recognized that FICA broadly defines the term "wages," and it agreed with the government that severance payments do not fall within any of the "statutory exceptions to [that] broad definition." *Id.* at 41a; see *id.* at 49a. The district court ruled in respondents' favor, however, on the same rationale as the bankruptcy court. The district court determined that the severance payments at issue here fall within Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits"; that Section 3402(*o*) reflects Congress's view that any payments covered by that definition are not wages for purposes of income-tax withholding; and that such payments therefore should not be treated as wages for purposes of FICA tax withholding. See *id.* at 49a-50a. The district court acknowledged that its decision was in conflict with the Federal Circuit's decision in *CSX Corp.* See *id.* at 51a-52a.

5. The court of appeals affirmed. App., *infra*, 1a-30a. Like the bankruptcy and district courts, the court of appeals did not rest its decision on the text of the relevant FICA provisions. Rather, the court reasoned that, under this Court's decision in *Rowan Cos., Inc.* v. *United*

States, 452 U.S. 247 (1981), "the statutory term 'wages' should be interpreted consistently in the statutes governing FICA and the federal income tax." App., *infra*, 19a. The court further concluded that the severance payments at issue here fall within the definition of "supplemental unemployment compensation benefits" in Section 3402(*o*)(2)(A). *Id.* at 11a.

The court of appeals explained that, under Section 3402(*o*)(1), "any payment made to an employee that meets the statutory definition of a [supplemental unemployment compensation] payment 'shall be treated *as if it were a payment of wages* by an employer to an employee for a payroll period.'" App., *infra*, 11a (quoting 26 U.S.C. 3402(*o*)(1)) (emphasis added by court of appeals). The court found that "the necessary implication arising from [the italicized] phrase is that Congress did not consider [supplemental unemployment compensation] payments to be 'wages,' but allowed their treatment as wages to facilitate federal income tax withholding for taxpayers." *Id.* at 11a-12a. The court further reasoned that, if such payments "are not 'wages' but are only treated as if they were 'wages' for purposes of federal income tax withholding, then [such] payments also are not 'wages' under the nearly identical definition of that term found in the FICA statute." *Id.* at 13a-14a. Like the district court, the court of appeals recognized that its decision was in conflict with the Federal Circuit's decision in *CSX Corp.* See *id.* at 20a.

REASONS FOR GRANTING THE PETITION

FICA broadly defines the term "wages" as all remuneration received for any service performed by an employee. See 26 U.S.C. 3121(a) and (b) (2006 & Supp. V 2011). The severance payments at issue in this case fit comfortably within that broad definition, which encom-

passes "the entire employer-employee relationship for which compensation is paid to the employee by the employer." *Social Sec. Bd.* v. *Nierotko*, 327 U.S. 358, 366 (1946). For several decades, moreover, the IRS has taken the position that payments like these are FICA wages, and Congress has taken no action to override that determination.

In holding that the severance payments here are not subject to FICA tax, the court of appeals did not suggest that those payments fall outside the applicable definition of "wages." Rather, the court relied on what it perceived to be the negative implication of 26 U.S.C. 3402(*o*), which mandates withholding of income tax from certain payments made to terminated employees. The court inferred that, because Section 3402(*o*)(2) states that any supplemental unemployment compensation benefit "shall be treated as if it were a payment of wages" for purposes of federal income-tax withholding, such payments should *not* be treated as wages for purposes of FICA taxation. As the Federal Circuit recognized in a factually analogous case, Section 3402(*o*) does not support that inference. See *CSX Corp.* v. *United States*, 518 F.3d 1328, 1340-1342 (2008). And, as the court below acknowledged (App., *infra*, 20a), the Sixth Circuit's decision in this case squarely conflicts with the Federal Circuit's decision in *CSX Corp.*

In addition to being in conflict with decisions of this Court and other courts of appeals, the question presented here is both recurring and important; the amount at issue for this and other claims exceeds $1 billion and is expected to grow. In light of the administrative importance of the issue, and the square circuit conflict, this Court's review is warranted.

A. The Decision Below Is Incorrect

1. a. FICA taxes finance Social Security and Medicare benefits. They are imposed on both employers and employees, and both elements of the tax are imposed on all "wages" paid by an employer or received by an employee "with respect to employment." 26 U.S.C. 3101(a) and (b), 3111(a) and (b). FICA defines "wages" in relevant part as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. 3121(a) (2006 & Supp. V 2011). The Act defines "employment" in turn as "any service, of whatever nature, performed * * * by an employee for the person employing him." 26 U.S.C. 3121(b) (2006 & Supp. V 2011). FICA thus defines "wages" to include "all remuneration" paid for "any service" performed by an employee. On their face, those inclusive terms "import a breadth of coverage." *Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S. Ct. 704, 715 (2011) (*Mayo Found.*) (quoting *Nierotko*, 327 U.S. at 365); *id.* at 709.

That broad definition of "wages" easily encompasses the severance payments at issue here. Those payments were undoubtedly a form of "remuneration." See, *e.g.*, *Black's Law Dictionary* 1409 (9th ed. 2009) (defining "remuneration" as "[p]ayment; compensation"); *Webster's Third New International Dictionary of the English Language* 1921 (1993) (defining "remunerate" as "to pay an equivalent to (a person) for a service, loss, or expense: recompense, compensate") (capitalization omitted); 8 *Oxford English Dictionary* 439 (1st ed. 1933) (defining "[r]emuneration" as "[r]eward, recompense, repayment; payment, pay"); see also *Nierotko*, 327 U.S. at 364 (concluding that "[s]urely" an award of back pay for an employee's wrongful discharge "is 'remuneration'").

Those payments were also made in return for "any service, of whatever nature, performed" by the employee. 26 U.S.C. 3121(b) (2006 & Supp. V 2011). The payments were calculated by reference to individual employees' positions, length of service, and former salaries.

This case involves payments made under two different severance plans, depending on whether employees were terminated before or after respondents entered into bankruptcy. Both plans made payments (either on a periodic basis or as a lump sum) once employees had been terminated, and both plans thus compensated those employees for their previous service. App., *infra*, 3a-4a. The post-petition plan served the further purpose of ensuring that, once respondents had entered bankruptcy, remaining employees would have an incentive to defer their job searches and dedicate their time and efforts to the company. *Id.* at 4a. Those employees who did so were then compensated for providing that additional service.

Both the pre-petition and post-petition severance plans at issue here provided compensation to employees for "service" that those employees had rendered to respondents. By defining "employment" expansively to include "any service, of whatever nature," FICA encompasses not only compensation for an employee's performance of specific functions but also compensation (like a bonus or severance payment) that accounts more generally for an employee's entire performance over some period of time. See, *e.g.*, *Rivera* v. *Baker West, Inc.*, 430 F.3d 1253, 1258 (9th Cir. 2005) (discussing "the broad, inclusive nature of 'employment'"); *Hemelt* v. *United States*, 122 F.3d 204, 209 (4th Cir. 1997) (same). FICA's inclusive definition of the terms "wages" and "employment" includes compensation based on and aris-

ing out of the employer-employee relationship, unless that type of compensation is excepted from the scope of the Act. The link between respondents' payments and the employees' prior service is particularly clear in this case because the amounts of the various employees' payments were calculated by reference to the positions those individuals had held within respondents' work force, the length of time the employees had worked for respondents, and the salaries they had earned during their periods of service.

b. FICA contains specific exceptions to both "wages" and "employment"—*i.e.*, types of remuneration that do not constitute wages, see 26 U.S.C. 3121(a)(1)-(23) (2006 & Supp. V 2011), and types of services that do not constitute employment, see 26 U.S.C. 3121(b)(1)-(21) (2006 & Supp. V 2011). This Court has observed that the specificity of the exceptions is an additional reason why the terms "wages" and "employment" should be construed broadly. See *United States* v. *Silk*, 331 U.S. 704, 711-712 (1947) ("The 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.") (footnote omitted); cf. *Mayo Found.*, 131 S. Ct. at 715 ("[W]e have instructed that 'exemptions from taxation are to be construed narrowly.'") (quoting *Bingler* v. *Johnson*, 394 U.S. 741, 752 (1969)). Respondents do not contend, and the court of appeals did not hold, that the severance payments at issue here fall within any of the statutory exceptions to "wages."

c. Between 1956 and 1990, the IRS issued numerous Revenue Rulings addressing whether particular payments to terminated employees should be treated as "wages" for purposes of income-tax or FICA withhold-

ing. See generally *CSX Corp.*, 518 F.3d at 1335-1340. Under the framework the IRS developed during that period, the severance payments at issue in this case are clearly FICA "wages."

i. In the mid-1950s, several large industrial employers adopted plans pursuant to collective bargaining in which the employers agreed to fund trusts that would supplement state unemployment compensation benefits for workers who were terminated. See *CSX Corp.*, 518 F.3d at 1334. Those supplemental benefits depended for their effectiveness on their not being treated as "wages," because employees in many States were ineligible for unemployment benefits if they were receiving wages from employers. As a result, if the supplemental benefits paid by employers were treated as wages, many employees would lose the state unemployment benefits that their employers' payments were intended to supplement. See *id.* at 1335.

In 1956, the IRS issued a Revenue Ruling addressing the status, for income-tax and FICA purposes, of payments made by one such trust. See Rev. Rul. 56-249, 1956-1 C.B. 488. The IRS identified eight different factors as supporting the conclusion that those payments were not "wages." The IRS explained, *inter alia*, that "the amount of [such] benefit[s] * * * is based upon * * * the appropriate State unemployment compensation laws." *Id.* at 492.

The plan at issue in the 1956 Revenue Ruling was the result of collective bargaining, and it created a trust to make periodic payments to terminated employees. Over the next four years, the IRS issued a series of Revenue Rulings explaining that the principles of the 1956 Revenue Ruling would apply with equal force to plans that were unilaterally instituted by an employer, Rev. Rul.

58-128, 1958-1 C.B. 89; that made lump sum rather than periodic payments to employees, see Rev. Rul. 59-227, 1959-2 C.B. 13; and that made payments directly to employees rather than through a trust, see Rev. Rul. 60-330, 1960-2 C.B. 46. The IRS specified, however, that in order not to result in the payment of "wages," plans had to be "similar in all material details" to the plan at issue in the 1956 Revenue Ruling. Rev. Rul. 58-128, 1958-1 C.B. at 90; see Rev. Rul. 60-330, 1960-2 C.B. at 48.

ii. Until 1950, the FICA definition of "wages" excluded "[d]ismissal payments which the employer is not legally required to make." 26 U.S.C. 1426(a)(4) (1946). In 1950, however, Congress amended FICA to eliminate that exception. See Social Security Act Amendments of 1950, ch. 809, 64 Stat. 477. Both before and after the passage of Section 3402(*o*), the IRS issued Revenue Rulings concluding that various types of dismissal payments were "wages." In 1965, the IRS ruled that "[l]ump sum separation and severance allowances paid to laid-off employees in the railroad industry" constituted "wages" subject to income-tax withholding and "compensation" subject to taxation under the Railroad Retirement Tax Act (which is the equivalent of FICA in the railroad industry). Rev. Rul. 65-251, 1965-2 C.B. 395. In 1971, the IRS ruled that "[d]ismissal payments made to former employees" were "wages" subject to both FICA tax and income-tax withholding. Rev. Rul. 71-408, 1971-2 C.B. 340. In that case, a company went out of business and made payments to terminated employees with five years or more service with the company. *Id.* at 341. As in this case, "[t]he computation of the amount of each employee's award took into account the employee's rate of pay and years of service." *Ibid.* The IRS concluded that

"the amounts of dismissal payments [were] 'wages' for purposes of [FICA]." *Ibid.*

iii. In 1990, the IRS set forth in detail its position on the relationship between the two categories of payments described above and the criteria that govern the determination whether particular payments to terminated employees are FICA "wages." The IRS explained that, to be exempt from FICA's definition of "wages," payments made to terminated employees must be "linked to state unemployment compensation" and "designed to supplement the receipt of state unemployment compensation." Rev. Rul. 90-72, 1990-2 C.B. 211, 212. Under that approach, the severance payments at issue here clearly are not exempt from FICA taxation because they are wholly unconnected to state unemployment compensation. Rather, like the dismissal payments found to be FICA "wages" in the 1971 Revenue Ruling, the payments are calculated by reference to individual employees' positions, length of service, and former salaries.

2. The court of appeals did not rest its analysis on the FICA provisions that define the terms "wages" and "employment," 26 U.S.C. 3121(a) and (b) (2006 & Supp. V 2011). Rather, the court relied on 26 U.S.C. 3402(*o*), which governs the withholding of federal income tax. App., *infra*, 10a-14a. Section 3402(*o*) is entitled "[e]xtension of withholding to certain payments other than wages" and states that "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." 26 U.S.C. 3402(*o*)(1)(A) (emphasis added).

The court of appeals held that the severance payments at issue in this case fall within the definition of "supplemental unemployment compensation benefit"

contained in Section 3402(*o*)(2)(A). See App., *infra*, 11a. Based on Congress's directive that any such payment "shall be treated as if it were a payment of wages" for purposes of income-tax withholding, the court inferred that payments covered by that definition are not *in fact* wages for income-tax purposes. See *id.* at 11a-12a. The court further determined that, under this Court's decision in *Rowan Cos., Inc.* v. *United States*, 452 U.S. 247 (1981), "the statutory term 'wages' should be interpreted consistently in the statutes governing FICA and the federal income tax." App., *infra*, 19a. The court concluded that, because (in its view) respondents' severance payments "are not 'wages' but are only treated as if they were 'wages' for purposes of federal income tax withholding, then [such] payments also are not 'wages' under the nearly identical definition of that term found in the FICA statute." *Id.* at 13a-14a. The court of appeals' chain of reasoning reflects significant misunderstandings of Section 3402(*o*)'s text, history, and purpose.

a. The court of appeals gave insufficient weight to the prefatory language of Section 3402(*o*)(1), which states that the rules therein—including the rule that supplemental unemployment compensation payments shall be treated as wages for purposes of income tax withholding—apply "[f]or purposes of this chapter (and so much of subtitle F as relates to this chapter)." The applicability of Section 3402(*o*)(1) is thus expressly limited to Chapter 24 (income tax withholding) and those portions of Subtitle F (matters of procedure and administration) that relate to Chapter 24. By contrast, FICA is codified at Chapter 21 of the Internal Revenue Code. As the Federal Circuit has explained, "Congress's decision to restrict the scope of the rule set forth in [S]ection 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." *CSX Corp.*, 518 F.3d at 1341. The court of appeals therefore should have construed FICA's definition of "wages" with reference to its own terms, not by drawing inferences from Section 3402(*o*).

b. The history of Section 3402(*o*) belies any suggestion that the provision was intended to exempt from FICA taxation payments that would otherwise be treated as FICA "wages." Rather, Section 3402(*o*) was Congress's response to a different problem dealing with a particular category of unemployment compensation benefits. As explained above, the IRS determined in 1956, and confirmed in later Revenue Rulings, that certain payments linked to state unemployment compensation schemes should not be viewed as "wages." The IRS's 1956 Revenue Ruling noted, however, that such payments were nevertheless "includible in the gross incomes" of recipients. Rev. Rul. 56-249, 1956-1 C.B. at 488; see *CSX Corp.*, 518 F.3d at 1336.

Because those supplemental payments were taxable as income to recipients, but were not subject to income-tax withholding as "wages," recipients found themselves subject to substantial tax obligations when they filed their returns. See *CSX Corp.*, 518 F.3d at 1336. In 1969, at the Treasury Department's suggestion, Congress enacted Section 3402(*o*) to address that particular problem. Section 3402(*o*) provides that "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." 26 U.S.C. 3402(*o*)(1)(A). Section 3402(*o*) thus ensures that supplemental unemployment compen-

sation benefits, even if not deemed wages, are subject to income-tax withholding by employers. Section 3402(*o*) also defines the term "supplemental unemployment compensation benefits" broadly to encompass the different types of plans that employers had developed prior to its enactment. See 26 U.S.C. 3402(*o*)(2)(A); see also *CSX Corp.*, 518 F.3d at 1336-1337.

As explained above, the IRS has long distinguished, for both FICA and income-tax purposes, between different types of payments made by employers to terminated employees. In enacting Section 3402(*o*), Congress did not seek either to redraw the line that the IRS had drawn, or to restrict the IRS's authority (within the limits established by other provisions of law) to determine which such payments should be treated as "wages." See Rev. Rul. 90-72, 1990-2 C.B. at 211 (explaining that "[t]he definition of [supplemental unemployment compensation benefit] pay under [S]ection 3402(o) is not applicable for FICA * * * purposes"). Congress simply addressed a practical difficulty that had arisen by reason of the fact that certain non-wage payments were still part of the recipient's gross income and therefore were ultimately subject to federal income tax even in the absence of withholding.

c. On its face, Section 3402(*o*)(2)(A)'s broad definition of "[s]upplemental unemployment compensation benefits" encompasses *both* the payments linked to state unemployment compensation that the IRS had historically treated as non-wage income, and the dismissal payments that the IRS had viewed as "wages." So long as Section 3402(*o*) is given only the effect that its language literally dictates (*i.e.*, that "supplemental unemployment compensation benefits" as defined in the statute be subject to income-tax withholding), the breadth of the statutory

definition is of no practical concern. "For purposes of chapter 24 (income tax withholding), it was not important for Congress to define [supplemental unemployment compensation benefit] payments narrowly or to distinguish between [supplemental unemployment compensation benefit] payments and 'dismissal' payments, since both were treated similarly for withholding purposes." *CSX Corp.*, 518 F.3d at 1340. If, in some of its applications, Section 3402(*o*) mandates withholding of income tax from payments that would *already* be subject to income-tax withholding, no practical harm is done.

The breadth of the statutory definition creates anomalous results, however, if payments within that definition are viewed for all purposes as non-wage income. As the Federal Circuit explained in *CSX Corp.*, "if [S]ection 3402(*o*) is deemed to render all [supplemental unemployment compensation benefit] payments (as defined therein) non-wages, and if the non-wage character of [supplemental unemployment compensation benefit] payments (as so defined) is deemed to apply to FICA, [Section 3402(*o*)] creates a square conflict with the treatment of dismissal payments as wages under FICA since 1950." 518 F.3d at 1341. Neither the text nor the history of Section 3402(*o*) provides any sound basis for construing it to override IRS practice in that manner. Section 3402(*o*) applies by its terms only for purposes of specified income-tax-related provisions, see pp. 15-16, *supra*, and it was designed to *increase* the incidence of income-tax withholding. If Congress had sought to *eliminate* FICA withholding from the sorts of dismissal payments that the IRS had historically treated as FICA wages, the language it used in Section 3402(*o*) would

have been a remarkably oblique way of accomplishing that result.

To be sure, Section 3402(*o*) reflects Congress's understanding that *some* of the payments encompassed by the statutory definition of "supplemental unemployment compensation benefits" would not otherwise be viewed as "wages." The provision would have served no useful purpose if *all* such payments were already subject to income-tax withholding. But "[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." *CSX Corp.*, 518 F.3d at 1342 (emphasis added).[2]

Thus, Section 3402(*o*) simply directs that payments encompassed by the statutory definition will be subject to income-tax withholding *whether or not* they would

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[2] The court of appeals also relied in part on the title of Section 3402(*o*), "Extension of withholding to certain payments other than wages." The court stated that "[t]he phrase 'other than wages' supports our conclusion that Congress knew that it was extending federal income tax withholding to payments 'other than wages' when it enacted [Section] 3402(*o*)." App., *infra*, 12a-13a. Under the government's reading, however, the purpose and effect of Section 3402(*o*) was to extend income-tax withholding to "payments other than wages," namely the payments related to state unemployment compensation that the IRS had treated, in the 1956 Revenue Ruling and subsequently, as non-wage income. The fact that the statutory definition of "supplemental unemployment compensation benefits" also encompasses some wage payments neither vitiates that intent nor renders the government's reading inconsistent with the title of Section 3402(*o*).

otherwise be "wages." The provision does not explicitly address, and has no logical bearing on, the determination whether particular payments to terminated employees are subject to FICA taxation. Rather, that determination is governed by other provisions of law. And, once Section 3402(*o*) is understood to be irrelevant to questions of FICA taxation, the severance payments at issue here clearly constitute FICA "wages." See pp. 8-14, *supra*.

B. The Decision Below Conflicts With Decisions Of This Court And Other Courts Of Appeals

1. The court of appeals' decision is inconsistent with this Court's decision in *Nierotko*, *supra*. In that case, an employee had been wrongfully discharged and was ordered to be reinstated by his employer with back pay. See 327 U.S. at 359-360. The question in *Nierotko* was whether the back pay award constituted "wages" under the Social Security Act, which defined that term in the same way as FICA. See *id.* at 362-363.

In applying that statutory definition, the Court in *Nierotko* first held that "the back pay is remuneration." 327 U.S. at 364 (internal quotation marks omitted). It then held that the back pay was awarded for the employee's "service," even though he had not worked during the period of his wrongful discharge. The Court explained that "[t]he 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." *Id.* at 365. The Court concluded that "'service' as used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship for which com-

pensation is paid to the employee by the employer." *Id.* at 365-366.

The Court's reasoning in *Nierotko* indicates that the severance payments at issue here constitute wages for FICA purposes. Respondents' severance payments were compensation for "service, of whatever nature, performed" by their employees, 26 U.S.C. 3121(b) (2006 & Supp V. 2011), because those payments were based on, and made on account of, "the entire employer-employee relationship," *Nierotko*, 327 U.S. at 366. The amount of employees' severance payments depended on their level of seniority, length of service with the company, and regular rate of pay. See pp. 3-4, *supra*. All of those factors depend on "the entire employer-employee relationship," and all of them are usual factors associated with determining the level of an employee's compensation. Just as this Court in *Nierotko* rejected the notion that "[a] back pay award differs from other pay," 327 U.S. at 368 (internal quotation marks omitted), the court of appeals should have rejected respondents' argument that a severance payment differs in kind from other types of pay received by employees in return for services rendered to their employers.

2. Nor does it matter that, unlike in *Nierotko*, the severance payments at issue here were made at the conclusion of employees' work for respondents. In *Otte* v. *United States*, 419 U.S. 43 (1974), former employees of a corporation that had declared bankruptcy filed claims with the trustee for unpaid wages. See *id.* at 45. The trustee proposed to pay the claims without withholding federal income and FICA taxes. See *id.* at 46. This Court held that such withholding was necessary. See *id.* at 49-51. The Court observed that the relevant income-tax provisions defined "wages" as remuneration for ser-

vices that an employee "performs or performed." *Id.* at 49. The Court thus reasoned that the statutory language "speaks in the past tense as well as the present and thereby plainly reveals that a continuing employment relationship is not a prerequisite for a payment's qualification as 'wages.'" *Id.* at 49-50. "The situation is the same with respect to FICA withholding," the Court explained, because "the payments clearly are 'wages' under that statute, even though again, at the time of payment, the employment relationship between the bankrupt and the claimant no longer exists." *Id.* at 51; see 26 U.S.C. 3121(b) (2006 & Supp. V 2011) (referring to "service, of whatever nature, *performed*" by an employee) (emphasis added).[3]

3. Since *Nierotko* and *Otte*, the Third and Federal Circuits have held that various types of severance payments made at the conclusion of a worker's employment relationship are "wages" for FICA purposes. See, *e.g.*, *University of Pittsburgh* v. *United States*, 507 F.3d 165, 171-172 (3d Cir. 2007) (early retirement payments to

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[3] The court of appeals' reliance (App., *infra*, 9a) on *Coffy* v. *Republic Steel Corp.*, 447 U.S. 191 (1980), is misplaced. Although *Coffy* involved payments made to laid-off employees, see *id.* at 198-199, the Court did not address whether those payments were "wages" for either FICA or income-tax purposes. Rather, the disputed issue was whether those payments were "perquisites of seniority" to which a returning veteran was entitled under the Vietnam Era Veterans' Readjustment Assistance Act of 1974. See *id.* at 193. In holding that the payments were covered by that statute, the Court emphasized that the payments were "in the nature of a reward for length of service, and do not represent deferred short-term compensation for services actually rendered." *Id.* at 205. *Nierotko* makes clear, however, that payments from an employer to an employee may be FICA "wages" even if they do not compensate the employee "for services actually rendered."

faculty members were "wages" taxable under FICA); *Abrahamsen* v. *United States*, 228 F.3d 1360, 1365 (Fed. Cir. 2000) (same; buyout payments to employees who agreed to resign or retire and release the employer from liability), cert. denied, 532 U.S. 957 (2001). Indeed, the Sixth Circuit itself reached the same conclusion in a similar case. See *Appoloni* v. *United States*, 450 F.3d 185, 191-192 (2006) (severance payments to public school teachers who agreed to resign statutory tenure rights and their teaching positions were "wages" taxable under FICA), cert. denied, 549 U.S. 1165 (2007). The Eighth Circuit has held that early retirement payments to high-level administrators, but not those made to tenured faculty members, were "wages" taxable under FICA, on the theory that the payments to tenured professors were made in exchange for relinquishment of contractual and constitutionally-protected rights, rather than as compensation for services rendered. See *North Dakota State Univ.* v. *United States*, 255 F.3d 599, 600 (2001). None of those courts treated 26 U.S.C. 3402(*o*) as in any way relevant to the determination whether particular payments were FICA "wages."

The Third and Federal Circuits have also recognized that when, as here, the amount of a payment to a departing employee is based on factors like the employee's salary and years of service to the company, those factors indicate that the payment is compensation for past services rendered by the employee. The payment therefore arises from the employer-employee relationship and constitutes "wages" for FICA purposes. See, *e.g.*, *University of Pittsburgh*, 507 F.3d at 172 ("[E]ligibility for the Plans * * * was based on the employee's age and years of service. These requirements link the Plan payments to past services for the employer * * * and

weigh heavily in favor of treating the payments as wages."); *Abrahamsen*, 228 F.3d at 1365 ("[T]he agreements set the amount of the lump-sum cash payments using a formula based on the departing employee's salary and years of service * * * . This formula further associates the payments with the employer-employee relationship."). Again, the Sixth Circuit recognized the same thing in its earlier decision in *Appoloni*. See 450 F.3d at 191 ("[T]he eligibility requirements for qualifying for a payment—that a teacher served a minimum number of years—indicate the payments were for services performed."). Applying that reasoning here would have resulted in a different outcome.

4. Most recently, the Federal Circuit held in *CSX Corp.* that severance payments made in connection with a company's reduction in force are "wages" for purposes of FICA taxation. See 518 F.3d at 1352. In *CSX Corp.*, a group of railroad companies responded to financial difficulties by paying a number of their employees to leave their jobs or reduce their hours. See *id.* at 1330. The Federal Circuit followed the majority of courts of appeals in determining that a severance payment "designed to induce the employee to leave or to cushion the effect of a separation * * * constitute[s] taxable wages and compensation." *Id.* at 1348; see *id.* at 1347-1349. In so concluding, the Federal Circuit rejected the very argument that the Sixth Circuit adopted here: namely, that all severance payments encompassed by Section 3402(*o*)(2)(A)'s definition of "supplemental unemployment compensation benefits" should be considered nonwage payments for FICA purposes. See *id.* at 1341-1345. The decision below thus squarely conflicts with the Federal Circuit's decision in *CSX Corp.*, as the

courts below recognized. See App., *infra*, 20a, 51a-52a. This Court's review is warranted to resolve the conflict.

C. The Question Presented Is Recurring And Exceptionally Important

The proper tax treatment of severance pay under FICA is an issue of exceptional importance. According to the IRS, that question is currently pending in eleven cases and more than 2400 administrative refund claims, with a total amount at stake of more than $1 billion. That figure is expected to grow. In addition, the decision below has significant potential implications outside the tax context with respect to the administration of Social Security and Railroad Retirement Act benefits. A payment's designation as "wages" affects whether employees earn wage credits, which in turn affects the amount of benefits that employees accrue. See 42 U.S.C. 401 *et seq.*; see also 20 C.F.R. 404.1001. In light of the substantial effect that the decision below will have both on the public fisc and on employers and employees in the Sixth Circuit, this Court's review is warranted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 2013

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 10-1563

IN RE QUALITY STORES, INC., ET AL., DEBTORS
UNITED STATES OF AMERICA, APPELLANT

v.

QUALITY STORES, INC., ET AL., APPELLEES

Argued: Oct. 6, 2011
Decided and Filed: Sept. 7, 2012

OPINION

Before: BOGGS and STRANCH, Circuit Judges; and CARR, District Judge.*

JANE B. STRANCH, Circuit Judge.

This appeal arises from an adversary action filed in the bankruptcy court for the Western District of Michigan by Quality Stores, Inc., its affiliated companies, and certain employees (collectively Quality Stores) against the United

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* The Honorable James G. Carr, Senior United States District Judge for the Northern District of Ohio, sitting by designation.

States seeking a refund of $1,000,125 in taxes paid under the Federal Insurance Contributions Act (FICA).[1] On stipulated facts and cross-motions for summary judgment, the bankruptcy court ordered a full refund, holding that payments Quality Stores made to its employees upon terminating their employment involuntarily due to business cessation constituted supplemental unemployment compensation benefits (SUB payments) that are not taxable as wages under FICA. *Quality Stores, Inc. v. United States* (*In re Quality Stores, Inc.*), 383 B.R. 67 (Bankr. W.D. Mich. 2008). On appeal, the district court affirmed, *United States v. Quality Stores, Inc.* (*In re Quality Stores, Inc.*), 424 B.R. 237 (W.D. Mich. 2010), and we now AFFIRM.

I. FACTS

Quality Stores was the largest agricultural-specialty retailer in the country serving farmers, hobby gardeners, skilled trade persons, and do-it-yourself customers. In October 2001, an involuntary Chapter 11 bankruptcy petition was filed against Quality Stores, Inc. Within two weeks, Quality Stores answered the petition and consented to the entry of an order for relief. Thereafter, Quality Stores's affiliated companies commenced voluntary Chapter 11 bankruptcy cases.[2] In May 2002, the

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[1] Quality Stores is supported in this appeal by *amici curiae*, American Payroll Association and ERISA Industry Committee.

[2] The debtors are: QSI Holdings, Inc. (f/k/a CT Holdings, Inc.), Quality Stores, Inc. (f/k/a Central Tractor Farm & Country, Inc.), Country General, Inc., F and C Holding, Inc., FarmandCountry .com, LLC, QSI Newco, Inc., QSI Transportation, Inc., Quality

bankruptcy court confirmed the First Amended Joint Plan of Reorganization.

Prior to November 1, 2001, Quality Stores closed sixty-three stores and nine distribution centers and terminated the employment of approximately seventy-five employees in the corporate office. After November 1, 2001, Quality Stores closed its remaining 311 stores and three distribution centers and terminated the employment of all remaining employees.

Quality Stores made severance payments to those employees whose employment was involuntarily terminated. The parties stipulated that the severance payments resulted directly from a reduction in force or the discontinuance of a plant or operation. Quality Stores made the severance payments pursuant to two separate plans.

Under the terms of the Pre-Petition Severance Plan, severance pay was based on job grade and management level in the organization. The President and CEO received eighteen months of severance pay. Senior management executives received twelve months of severance pay, while all other managers and employees received one week of severance pay for each full year of service. These severance payments were not tied to the receipt of state unemployment compensation, and they were not attributable to the provision of any particular services by the employees. Quality Stores made the severance pay-

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Farm & Fleet, Inc., Quality Investments, Inc., Quality Stores Services, Inc., and Vision Transportation, Inc.

ments on the normal payroll schedule. Salaried employees received an average of 11.4 weeks of severance pay, while hourly employees received an average of 4.2 weeks of severance pay.

The Post-Petition Severance Plan was designed to encourage employees to defer their job searches and dedicate their efforts and attention to the company by assuring them that they would receive severance pay if their jobs were eliminated. To be eligible for severance pay, an employee was required to complete the last day of service as scheduled. Company officers received between six and twelve months of severance pay, while full-time salaried and hourly employees who had been employed for at least two years received one week of severance pay for every full year of service, up to a maximum of ten weeks for salaried employees and five weeks for hourly employees. Those workers with less than two years of service received one week of severance pay.

Severance payments made under the Post-Petition Severance Plan were not tied to the receipt of state unemployment compensation, nor were they attributable to the provision of any particular services. The post-petition severance amounts were paid in a lump sum, however, because the companies were liquidating and it was not practical administratively to pay the amounts over time. Under the Post-Petition Severance Plan, on average, salaried employees received 5.2 weeks of severance pay, while hourly employees received 3.1 weeks of severance pay. About 900 employees did not receive any severance pay because they were hired immediately by successor companies.

Quality Stores did not require employees to prove that they were unemployed in order to receive severance pay under either plan. Because the severance payments constituted gross income to the employees for federal income tax purposes, Quality Stores reported the payments as wages on W-2 forms and withheld federal income tax. Quality Stores also paid the employer's share of FICA tax and withheld each employee's share of FICA tax. For the taxable quarters ending December 31, 1999, through June 30, 2002, Quality Stores filed timely Forms 941 reporting wages paid to employees and remitted the applicable FICA taxes.

Of the total $1,000,125 in FICA tax at issue, $382,362 is attributed to severance payments made under the Pre-Petition Severance Plan, consisting of $214,000 for the employer share and $168,362 for the employee share. Further, of the total amount of FICA tax at issue, $617,763 is attributed to severance payments made under the Post-Petition Severance Plan, consisting of $357,127 for the employer share and $260,636 for the employee share.

Although Quality Stores collected and paid the FICA tax, it did not agree with the Internal Revenue Service (IRS) that the severance payments constituted wages for FICA purposes. Quality Stores took the position that the payments made to its employees pursuant to the plans were not wages but instead constituted SUB payments that were not taxable under FICA.

Quality Stores asked 3,100 former employees to allow the company to file FICA tax refund claims on their behalf. *See* Treas. Reg. § 31.6402(a)-2. Of those con-

tacted, 1,850 former employees allowed Quality Stores to pursue FICA tax refunds for them.

In September 2002, Quality Stores timely filed with the IRS fifteen Forms 843 seeking the refund of $1,000,125 in FICA tax.[3] This figure consisted of $571,127 for the employer share and $428,998 for the employee share attributed to those employees who granted Quality Stores consent to pursue their claims. When the IRS did not allow or deny the refund claims, Quality Stores filed an adversary action in the bankruptcy court in June 2005.

II. STANDARD OF REVIEW

When we consider an appeal from a district court judgment in a case that originated in bankruptcy court, we review the bankruptcy court's decision directly, without giving any deference to the district court's decision. *Stevenson v. J.C. Bradford & Co. (In re Cannon),* 277 F.3d 838, 849 (6th Cir. 2002). Because the bankruptcy court decided the case on stipulated facts and cross-motions for summary judgment, our review is *de novo. See id.*

III. ANALYSIS

The concept of SUB payments first appeared in the 1950s and "evolved from the demand by organized labor for a guaranteed annual wage." *Coffy v. Republic Steel Corp.,* 447 U.S. 191, 200, 100 S. Ct. 2100, 65 L. Ed. 2d 53 (1980). Because the unions' real concern was the signif-

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[3] The Forms 843 were filed by Central Tractor Farm & Country, Inc., Country General, Inc., Quality Farm & Fleet, Inc., and Quality Stores Services, Inc.

icant difference between average weekly earnings received when employed and the amount of unemployment benefits received when unemployed, the unions sought corporate supplementation of existing state unemployment compensation programs. *See id.* Several industries adopted SUB plans, the purpose of which was to assure workers of employment security regardless of the number of hours actually worked, rather than to provide employees with additional compensation for work performed. *Id.* SUB payments "cannot be compensation for work performed, . . . for they are contingent on the employee's being thrown out of work; unless the employee is laid off he will never receive SUB payments. In this sense, SUB's are analogous to severance payments: they are 'compensation for loss of jobs.'" *Id.* (quoting *Accardi v. Pa. R.R. Co.*, 383 U.S. 225, 230, 86 S. Ct. 768, 15 L. Ed. 2d 717 (1966) ("[T]he cost to an employee of losing his job is not measured by how much work he did in the past . . . but by the rights and benefits he forfeits by giving up his job.")) SUB payments are "in the nature of a reward for length of service, and do not represent deferred short-term compensation for services actually rendered." *Id.* at 205, 100 S. Ct. 2100.

Consistent with these principles, Quality Stores developed two written plans to administer severance payments to the managers and hourly employees who permanently lost their jobs due to the cessation of business caused by bankruptcy. The related questions we must resolve are whether those payments constitute SUB pay-

ments under federal law and, if so, whether the payments are taxable under FICA.

A. Background

Congress imposed the FICA tax on employee wages to fund the Social Security and Medicare programs. *Appoloni v. United States*, 450 F.3d 185, 189 (6th Cir. 2006). Both the employer and the employee pay part of the tax. The employer collects the employee's share by deducting the tax from wages as they are paid. I.R.C. §§ 3101(a), 3102(a). The employer also pays a matching tax on the wages paid to the employee. I.R.C. § 3111(a).

Congress defined "wages" for FICA purposes (with certain exceptions) as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. . . . " I.R.C. § 3121(a). "Employment," as used in the statute, means "any service, of whatever nature, performed . . . by an employee for the person employing him. . . . " I.R.C. § 3121(b). The Supreme Court has explained that the 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.

Soc. Sec. Bd. v. Nierotko, 327 U.S. 358, 365-66, 66 S. Ct. 637, 90 L. Ed. 718 (1946). Thus, the Supreme Court held that back pay granted to an employee pursuant to an order of the National Labor Relations Board constituted "wages" taxable under FICA. *Id.* at 369-70, 66 S. Ct. 637. Likewise, we have construed FICA definitions broadly and inclusively, *Appoloni*, 450 F.3d at 190, and we generally favor "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); *United States v. Detroit Med. Ctr.,* 557 F.3d 412, 414 (6th Cir. 2009). But in this case we must begin with the Supreme Court's particular instruction that SUB pay falls outside the broad statutory meaning of service performed by an employee for an employer because, by definition, an employee is not eligible for SUB pay until service to the employer has ended and such benefits provide compensation for the lost job. *Coffy,* 447 U.S. at 200, 100 S. Ct. 2100.

B. FICA, Federal Income Tax Withholding, and "Wages"

Whether SUB payments are "wages" under FICA is a complex question because the FICA statute does not expressly include or exclude SUB payments, nor do the Treasury regulations promulgated under FICA address the subject. Mindful of the Supreme Court's admonition that SUB payments cannot, by their nature, be compensation for work performed, *id.,* we first ask whether Congress has provided any direction or insight into the proper treatment of SUB payments for tax purposes.

We observe that, for purposes of federal income tax withholding, I.R.C. § 3402, Congress adopted a definition of "wages" that is nearly identical to the definition of "wages" included in FICA. In the income tax context, "wages" means "all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash. . . . " I.R.C. § 3401(a). In addition to this definition of "wages," Congress expressly defined SUB payments for purposes of federal income tax withholding in a subsection of the statute entitled, **"Extension of withholding to certain payments *other than wages.*"** I.R.C. § 3402(*o*) (emphasis added). In that subsection of the statute, Congress defined SUB payments 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 (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.

I.R.C. § 3402(*o*)(2)(A). This statutory definition of SUB payments is repeated in the corresponding Treasury Regulation, § 31.3401(a)-1(b)(14)(ii).

Parsing this definition into its five separate elements, Congress has provided that a SUB payment is: (1) an amount paid to an employee; (2) pursuant to an employer's plan; (3) because of an employee's involuntary separation from employment, whether temporary or perma-

nent; (4) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions; and (5) included in the employee's gross income.

All payments Quality Stores made to its former employees, whether under the Pre- or Post-Petition Plan, satisfy this five-part statutory test to qualify as SUB payments. The parties stipulated below that: (1) Quality Stores made the payments to employees; (2) pursuant to company plans; (3) because of the employees' permanent separation from employment; and (4) resulting directly from a reduction in force or the discontinuance of a plant or operation. Although the parties' stipulation did not contain any reference to gross income as contemplated by the fifth element of the statutory test, as a matter of law the SUB payments were included in the employees' gross incomes. *See* I.R.C. § 61 (generally "gross income means all income from whatever source derived" with certain inapplicable exceptions). The statutory definition does not require that SUB payments be tied to an employee's receipt of state unemployment compensation benefits, nor does the statute make any distinction between periodic payments or one-time payments made in a lump sum.

Congress expressly provided that any payment made to an employee that meets the statutory definition of a SUB payment "shall be treated *as if it were a payment of wages* by an employer to an employee for a payroll period." I.R.C. § 3402(*o*)(1) (emphasis added). In our view, the necessary implication arising from this phrase is that Congress did not consider SUB payments to be "wages,"

but allowed their treatment as wages to facilitate federal income tax withholding for taxpayers. To the extent other plausible inferences might be drawn, the statute may be ambiguous.

Our objective when interpreting statutes is to give effect to the intent of Congress, and if that intent is clear, then both the courts and the government agency charged with implementing the statute, here the IRS, must give effect to that clear congressional intent. *See Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 665, 127 S. Ct. 2518, 168 L. Ed. 2d 467 (2007). If a statute is silent or ambiguous, the question we ask is whether the agency's approach to interpretation is based on a permissible construction of the statute. *Id.*

Where ambiguity exists, we may use aids to statutory construction to help us resolve the ambiguity. We may consider the title of the statute and the legislative history leading to its enactment, although the title and history cannot limit the plain meaning of the statutory text. *See Maguire v. Comm'r of Internal Revenue*, 313 U.S. 1, 9, 61 S. Ct. 789, 85 L.Ed. 1149 (1941); *Fairport, P. & E.R. Co. v. Meredith*, 292 U.S. 589, 594, 54 S. Ct. 826, 78 L. Ed. 1446 (1934). Thus, we turn to the title and legislative history of § 3402(*o*) to assist us in determining whether the inference we read into the statute is consistent with congressional intent.

The title of § 3402(*o*) is: **"Extension of withholding to certain payments other than wages."** The phrase "other than wages" supports our conclusion that Congress knew

that it was extending federal income tax withholding to payments "other than wages" when it enacted § 3402(*o*).

Moreover, the legislative history of the statute confirms our interpretation. When § 3402(*o*) was enacted in 1969, Congress recognized that SUB payments "are not subject to [federal income tax] withholding because *they do not constitute wages or remuneration for services.*" S. Rep. No. 91-552, at 255-56 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2305 (emphasis added). Because SUB payments "are generally taxable income to the recipient," however, Congress decided to require federal income tax withholding on SUB payments to alleviate any unexpected income tax burden on employees for the calendar year in which the payments were made. *Id.* Congress stressed "that *although these benefits are not wages*, since they are generally taxable payments they should be subject to withholding to avoid the final tax payment problem for employees." *Id.* (emphasis added). As a result of the enactment of § 3402(*o*), the "withholding requirements . . . *on wages* are to apply to these non-wage payments." *Id.* at 2306 (emphasis added).

Because the title and legislative history clarify any ambiguity in the statute, we are convinced that Congress characterized SUB payments as "non-wages" and Congress enacted § 3402(*o*) simply to extend withholding to these "non-wage" payments to benefit taxpayers. In light of this clear congressional intent, we approve the bankruptcy court's reasoning that if SUB payments are not "wages" but are only treated as if they were "wages" for purposes of federal income tax withholding, then SUB

payments also are not "wages" under the nearly identical definition of that term found in the FICA statute. The analytical bridge for this step in our reasoning arises from the Supreme Court's decision in *Rowan Cos. v. United States*, 452 U.S. 247, 255-57, 101 S. Ct. 2288, 68 L. Ed. 2d 814 (1981).

C. Application of *Rowan Cos. v. United States*

In *Rowan*, the Supreme Court examined the plain language and legislative history of § 3121(a) and § 3401(a) to conclude that Congress intended the term "wages" to carry the same meaning for purposes of FICA and federal income tax withholding. *Id.* at 257, 101 S. Ct. 2288. By adopting virtually identical definitions of "wages" in the two statutes, Congress expressed an intent to coordinate the two statutory schemes "to promote simplicity and ease of administration." *Id.* The Court said that "[i]t would be extraordinary for a Congress pursuing this interest to intend, without ever saying so, for identical definitions to be interpreted differently." *Id.* Upon concluding that "wages" means the same thing under FICA as it does for federal income tax, the Supreme Court invalidated certain Treasury regulations under which the IRS characterized meals and lodging provided to employees as "wages" under FICA but not as "wages" for purposes of federal income tax withholding. *Id.* at 249-50, 263, 101 S. Ct. 2288.

The government contends that Congress legislatively superseded *Rowan* when it enacted the "decoupling amendment" as part of the Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65. Without doubt,

the legislative history of the "decoupling amendment" reveals that Congress believed the objectives of the Social Security system were "significantly different from the objective[s] underlying the income tax withholding rules" and that "amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion." S. Rep. No. 98-23, at 42 (1983), *reprinted in* 1983 U.S.C.C.A.N. 143, 183. Thus, the legislative history explains, "the determination whether or not amounts are includible in the Social Security wage 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." *Id.* *See also* H.R. Rep. No. 98-25(I), at 80 (1983), *reprinted in* 1983 U.S.C.C.A.N. 219, 299; H.R. Conf. Rep. No. 98-47, at 148 (1983), *reprinted in* 1983 U.S.C.C.A.N. 404, 438.

This statement of congressional intent in the legislative history might change our analysis if Congress had actually passed a statute expressing it. But the actual language Congress used when it enacted the "decoupling amendment" did not achieve its intended effect as expressed in the legislative history. *See CSX Corp. v. United States*, 518 F.3d 1328, 1344 (Fed. Cir. 2008). The decoupling amendment reads:

> 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 sim-

> ilar exclusion from "wages" *in the regulations* prescribed for purposes of this chapter [22 relating to FICA]. Except as *otherwise provided in regulations* prescribed by the Secretary, any third party which makes a payment included in wages solely by reason of the parenthetical matter contained in subparagraph (A) of paragraph (2) shall be treated for purposes of this chapter and chapter 22 as the employer with respect to such wages.

I.R.C. § 3121(a) (emphasis added). Thus, "although the committee reports clearly state the intention to decouple the term 'wages' for purposes of income tax withholding and FICA," the statutory language actually "addresses the construction of the regulations." *CSX Corp.,* 518 F.3d at 1344. The decoupling amendment does not provide that "wages" must be treated differently for purposes of federal income tax withholding and FICA; rather, the amendment as written simply allowed the United States Treasury "'to promulgate regulations to provide for different exclusions from "wages" under FICA than under the income tax withholding laws.'" *Id.* (quoting *Anderson v. United States,* 929 F.2d 648, 650 (Fed. Cir. 1991) (also rejecting the government's "decoupling amendment" argument)). Importantly, the Secretary of the Treasury has not promulgated any regulations under the "decoupling amendment." *Id.* Therefore, because the language of the "decoupling amendment" is incongruent with its legislative history, we conclude under a plain reading of the statute that Congress did not statutorily supersede *Rowan* and that the case remains good law.

The government cites several other cases to support its view that the "decoupling amendment" abrogated *Rowan* and that later congressional action to make the "decoupling amendment" retroactive removed any doubt about its impact. *See New England Baptist Hosp. v. United States,* 807 F.2d 280, 284 (1st Cir. 1986); *Canisius Coll. v. United States,* 799 F.2d 18, 21-22 (2d Cir. 1986); *Temple Univ. v. United States,* 769 F.2d 126, 131-33 (3d Cir. 1985); *STA of Balt.–ILA Container Royalty Fund v. United States,* 621 F. Supp. 1567, 1575 (D. Md. 1985), *aff'd,* 804 F.2d 296 (4th Cir. 1986); *Robert Morris Coll. v. United States,* 11 Cl. Ct. 546, 550-52 (1987). These cases do not affect our analysis for two reasons. First, we approvingly cited *Rowan* and its holding long after these cases were decided. *Gerbec v. United States,* 164 F.3d 1015, 1026 n.14 (6th Cir. 1999). Second, these cases failed to focus on the plain meaning of the statute, which, as we have explained, is not in sync with its legislative history, *see CSX Corp.,* 518 F.3d at 1344, and these cases did not address the Secretary's failure to promulgate regulations to implement the "decoupling amendment."

We also do not agree with the government that the Supreme Court eroded *Rowan* when it decided *Environmental Defense v. Duke Energy Corp.,* 549 U.S. 561, 127 S. Ct. 1423, 167 L. Ed. 2d 295 (2007). In *Duke Energy,* the Supreme Court explained that it did not reach its decision in *Rowan* "simply because a 'substantially identical' definition of 'wages' appeared in each of the different statutory provisions." *Id.* at 575, 127 S. Ct. 1423. Instead, the Court "relied on a manifest 'congressional concern for the interest of simplicity and ease of admin-

istration.' The FICA . . . regulations fell for failing to 'serve that interest,' not for defying definitional identity." *Id.* (internal citations omitted). The Supreme Court instructed that "[c]ontext counts," the government argues, because there is no "'effectively irrebuttable' presumption that the same defined term in different provisions of the same statute must 'be interpreted identically.'" *Id.* at 575-76, 127 S. Ct. 1423 (internal citations omitted).

Putting aside that we are not dealing here with the same defined term in different provisions of the same statute, we reject the government's reliance on *Duke Energy* for the same reasons stated by the Federal Circuit in *CSX Corp.,* 518 F.3d at 1344 n.4. While the concern for simplicity and ease of administration "may be less compelling in other statutory settings, such as the one at issue in the *Duke Energy* case, there is nothing in the [Supreme] Court's opinion in [*Duke Energy*] to suggest that it would take a different view of the relationship between chapter 24 and chapter 21 of the Internal Revenue Code, where the *Rowan* Court found an enhanced need for consistency." *Id.*

We also cannot conclude that *Rowan* was eroded in *Mayo Found. for Med. Educ. & Research v. United States,* — U.S. —, 131 S. Ct. 704, 178 L. Ed. 2d 588 (2011), where the Supreme Court held that stipends paid by the Mayo Foundation to medical residents who worked more than 40 hours per week but also engaged in academic pursuits constituted "wages" under FICA. Applying *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.,* 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984), the

Supreme Court deferred to a Treasury regulation on the subject. *Mayo Found.*, 131 S. Ct. at 712-13. The government contends that the Supreme Court rejected *Rowan*'s framework for examining the validity of Treasury regulations when it noted that "[s]ince *Rowan* . . . the administrative landscape has changed significantly." *Id.* at 713.

We cannot agree. The aspect of *Rowan* that informs our present analysis is its instruction that the statutory term "wages" should be interpreted consistently in the statutes governing FICA and the federal income tax. The Supreme Court did not address that aspect of *Rowan* in *Mayo Foundation.* Rather, the Court concerned itself with *Rowan*'s status as a pre-*Chevron* case that accorded less deference to a Treasury regulation than is now required under *Chevron.* *Id.* at 713-14. *Mayo Foundation* adds nothing of significance to our legal analysis.

The government argues that, even if *Rowan* remains good law, the result reached by the bankruptcy court in favor of Quality Stores is inconsistent with the thrust of *Rowan.* While the Supreme Court construed the FICA and income tax definitions of "wages" similarly in order to effectuate a congressional intent to promote "simplicity and ease of administration," *Rowan,* 452 U.S. at 257, 101 S. Ct. 2288, here, the government argues, the bankruptcy court's decision results in different treatment of SUB payments for purposes of FICA and income-tax withholding, which is precisely the situation *Rowan* sought to avoid.

This argument misses the target. Congress imposed federal income tax withholding on SUB payments because they qualify as gross income, not because they are "wages." Reading the definitions of "wages" found in the FICA and federal income tax statutes consistently, SUB payments do not constitute "wages" under either statutory scheme.

Rowan remains good law, and the Federal Circuit agrees with us on this point. *CSX Corp.*, 518 F.3d at 1344 & n.4. That court, however, confined the congressional definition of SUB pay in I.R.C. § 3402(*o*) to federal income tax withholding only and did not rely on *Rowan* to conclude that the same statutory definition applies to FICA tax. *Id.* at 1340-42, 1345. In doing so, the Federal Circuit appears to have created an inconsistency within its own law. *Id.* at 1344 (observing that *Anderson v. United States*, 929 F.2d 648 (Fed. Cir. 1991), "held that the term 'including benefits' in the definition of wages under FICA must be accorded the same meaning as the identical term used in the income tax statutes.") By contrast to the analysis of the Federal Circuit, we rely on *Rowan* to reach the conclusion that if Congress decided to treat SUB payments as if they were "wages" for purposes of federal income tax withholding, then the same definition must apply under FICA.

D. Summary

Accordingly, we conclude, under the stipulated facts of this case, that the payments Quality Stores made to its employees pursuant to the Pre-and Post-Petition Plans qualify as SUB payments under I.R.C. § 3402(*o*). Be-

cause Congress has provided that SUB payments are not "wages" and are treated only as if they were "wages" for purposes of federal income tax withholding, such payments are not "wages" for purposes of FICA taxation.[4] We are cognizant of our prior decision construing payments made to teachers in exchange for relinquishment of their statutory tenure rights as "wages" taxable under

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[4] Other subsections of the statute allow federal withholding with respect to certain payments made to employees for annuities and sick pay. I.R.C. § 3402(*o*)(1)(B) & (C). The government argues it was unnecessary for Congress to exclude annuity payments and sick pay from the FICA definition of "wages" if, under I.R.C. § 3402(*o*), those payments were already considered non-wage payments for FICA purposes.

The bankruptcy court responded to this argument by noting that "the reason for these exclusions is explained by the disparate nature of the types of payments." *In re Quality Stores, Inc.*, 383 B.R. at 76. For instance, annuity payments are considered "remuneration for services" and thus are deemed to be "wages" for both FICA and federal income tax withholding, but Congress specifically excluded annuity payments from the definition of "wages" under chapters 21 (FICA) and 24 (federal income tax) of the Tax Code. *See* I.R.C. §§ 3121(a)(5)(B), 3401(a)(12)(B). By enacting § 3402(*o*), the court reasoned, Congress gave employees the option to request federal income tax withholding on annuity payments to avoid an unexpectedly large income tax bill. By contrast, SUB payments are not "remuneration for services," so such payments do not initially fall within the statutory definition of "wages." Therefore, there was no need for Congress to specifically exclude them from FICA tax, yet federal income taxpayers were provided the same option for federal income tax withholding. *In re Quality Stores, Inc.*, 383 B.R. at 76. The same analysis applies to sick pay. *Id.*

In light of *Coffy* and our entire analysis, we adopt the bankruptcy court's reasoning on this point.

FICA, *Appoloni,* 450 F.3d at 196, but in that case we did not examine the meaning of SUB pay or the interpretation of I.R.C. § 3402(*o*). Nor did we examine those issues in *Gerbec,* 164 F.3d at 1026, where we held that certain awards representing lost back pay and future wages amounted to compensation paid to the employee because of the employer-employee relationship and thus were taxable under FICA. We have also considered our prior holding that payments employees received from the residual balance of a terminated supplemental employment benefit trust fund constituted "wages" for the purpose of the FICA tax because they were solely derived from employer contributions and were contingent on past or present employment. *Sheet Metal Workers Local 141 Supplemental Unemployment Benefit Trust Fund v. United States,* 64 F.3d 245, 250-51 (6th Cir. 1995). In that case, the fund did not argue that the residual balance payments "were supplemental unemployment benefits which are exempt from FICA" tax. *Id.* at 251 n.4. Therefore, these prior cases do not impact our analysis here.

E. IRS Revenue Rulings Conflict With Congressional Intent

Having detailed the reasons why we affirm the bankruptcy court, we also explain why we do not adopt the government's other arguments or follow the IRS revenue rulings the government cites. In many respects, we find the arguments and revenue rulings to be inconsistent with the intent of Congress as expressed in the statutes and the legislative history as discussed above.

The government argues that, prior to 1950 when SUB pay had not yet been conceived, "dismissal pay" was specifically excluded from the definition of "wages" under FICA, 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), and Congress repealed the exclusion for "dismissal pay" in the Social Security Act Amendments of 1949, thus making all "dismissal pay" subject to FICA tax, *see* Pub. L. No. 81-734, ch. 809, 64 Stat. 477. The Federal Circuit adopted the government's position, *see CSX Corp.,* 518 F.3d at 1334, but we do not agree with the government's historical assessment of the law.

Prior to 1950, most "dismissal pay" was *not* excluded from the FICA definition of "wages." Only a small category—those payments an employer was not legally required to make—was excluded. S. Rep. No. 76-734, at 54 (1939) (accompanying H.R. 6635, amending the Social Security Act). The Social Security Act Amendments of 1949 eliminated the exclusion for "dismissal payments" an employer was not legally required to make:

> 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 . . . irrespective of whether the

> employer is, or is not, legally required to make such payment.

H.R. Rep. No. 1300, at 124 (1949). In any event, we agree that at the time SUB pay was conceived in the 1950s, all "dismissal payments" made to employees qualified as FICA "wages" for purposes of taxation.

When employers began adopting plans under collective bargaining agreements to fund trusts for the purpose of making SUB payments to employees in the event of unexpected job lay-off or termination, it was critical that SUB payments not be characterized as "wages." If SUB payments constituted "wages," then unemployed workers could not qualify for unemployment benefits under most states' laws, and the unavailability of unemployment benefits would largely defeat the purpose of SUB payments. Employers thus sought the guidance of the IRS to determine whether payments from their SUB plans would be characterized as taxable "wages."

In 1956, based on the specific facts of the employer plan before it, the IRS determined that SUB payments did not constitute "wages" for purposes of taxation under FICA and the Federal Unemployment Tax Act ("FUTA") because eight elements were met: (1) the benefits were paid only to unemployed former employees who were laid off by the employer; (2) eligibility for benefits depended on meeting prescribed conditions after employment terminated; (3) benefits were paid by trustees of independent trusts; (4) the amount of weekly benefits payable was based on state unemployment benefits, other compensation allowed under state unemployment laws, and

the amount of straight-time weekly pay after withholding all taxes and contributions; (5) the duration of the benefits was affected by the fund level and the employee's seniority; (6) the right to benefits did not accrue until a prescribed period after termination of employment; (7) the benefits were not attributable to the rendering of any particular services; and (8) no employee had any right, title, or interest in the fund until such employee was qualified and eligible to receive benefits. Rev. Rul. 56-249, 1956-1 C.B. 488. The IRS ruled, however, that even SUB payments meeting this definition must still be included in the gross income of the recipient for federal income tax purposes.[5] *Id.*

The IRS subsequently considered a SUB plan that was unilaterally instituted by the employer without union negotiation, Rev. Rul. 58-128, 1958-1 C.B. 89, and a SUB plan that allowed the employer to pay benefits to employees directly without use of a separate trust, Rev. Rul. 60-330, 1960-2 C.B. 46. In both situations, the IRS ruled that the SUB payments were excluded from FICA "wages" because the plans were otherwise similar in all material respects to the plan evaluated in Rev. Rul. 56-249. The IRS also ruled that the same principles applied if lump sum payments were made, rather than payments over a period of time. Rev. Rul. 59-227, 1959-2 C.B. 13.

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[5] There are substantial differences in the IRS eight-part test and the five-part test Congress later adopted, as discussed previously in this opinion.

In 1960, Congress amended the Internal Revenue Code to provide an income-tax exemption for SUB trusts. Pub. L. No. 86-667, 74 Stat. 534 (1960). In doing so, Congress defined SUB pay as "benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions . . . ." 74 Stat. 535. This definition remains in the statute today, I.R.C. § 501(c)(17), and it closely mirrors the SUB pay definition Congress later added to the federal income tax withholding statute in 1969, as discussed earlier in this opinion. I.R.C. § 3402(*o*)(2)(A). Because Congress knew that employers had developed a variety of SUB plans, it wished to facilitate the tax-exempt status of SUB plans because they provide "worthwhile benefits, but at the same time are not in competition with profit-making enterprises." S. Rep. No. 86-1518 (1960), *reprinted in* 1960 U.S.C.C.A.N. 3203, 3205.

In 1971, after Congress added its own definitions of SUB pay to § 501(c)(17) and § 3402(*o*)(2)(A), the IRS issued another revenue ruling in which it considered an agreement between an employer and a union under which the employer made awards to employees who were separated from service based on the employees' rate of pay and years of service. Relying on the "dismissal payment" amendment to the Social Security Act that took effect in 1950 and the "dismissal payment" regulation in the federal income tax withholding regulations, Treas. Reg. § 31.3401(a)-1(b)(4), the IRS determined that the

"dismissal payments" constituted taxable "wages" under FICA.[6] Rev. Rul. 71-408, 1971-2 C.B. 340. Soon thereafter, the IRS reached the same conclusion in addressing a "dismissal payment" where the employer and the employee had contractually agreed that the employer would make "dismissal payments" if the employer terminated the employee early. Rev. Rul. 74-252, 1974-1 C.B. 287.

In 1977, the IRS determined that a SUB plan, although not directly tied to the receipt of state unemployment compensation benefits, was substantially the same as the plan discussed in Rev. Rul. 56-249. Rev. Rul. 77-347, 1977-2 C.B. 362. Because the payments made under that plan did not disqualify the employees from receiving state unemployment benefits, the IRS found that the payments were SUB payments as defined by Congress in § 3402(*o*) and were not subject to FICA tax. The IRS modified and amplified Rev. Rul. 56-249 and Rev. Rul. 58-128 to reflect the change in the Tax Code that Congress effectuated in 1969 when it enacted § 3402(*o*). Thus, Rev. Rul. 77-347 is consistent with both our conclusion and that of the bankruptcy court that because SUB payments are not "wages" and are only treated as if they were "wages" under § 3402(*o*), SUB payments also are not "wages" under FICA.

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[6] Treasury Regulation § 31.3401(a)-1(b)(4) provides that "dismissal payments" are "[a]ny payments made by an employer to an employee on account of dismissal, that is, involuntary separation from the service of the employer, [which] constitute wages regardless of whether the employer is legally bound by contract, statute, or otherwise to make such payments."

The IRS later reversed itself on this point, however, stating that the "definition of SUB pay under section 3402(*o*) is not applicable for FICA. . . . SUB pay is defined solely through a series of administrative pronouncements published by the Service." Rev. Rul. 90-72, 1990-2 C.B. 211. To be exempt from "wages" under FICA, the IRS reasoned, SUB payments must be made to involuntarily separated employees pursuant to a plan that is designed to supplement the receipt of state unemployment compensation. *Id.* Moreover, the IRS ruled that payments in a lump sum are not considered linked to state unemployment compensation and therefore are not excludable from FICA "wages." *Id.* The IRS specified that it issued the ruling to "restore[ ] the distinction between SUB pay and dismissal pay by re-establishing the link between SUB pay and state unemployment compensation set forth in Rev. Rul. 56-249." *Id.*

In *CSX Corp.*, 518 F.3d at 1346, the Federal Circuit adopted the IRS's eight-part administrative definition of SUB pay set out in Rev. Rul. No. 56-249 and Rev. Rul. 90-72 rather than the express statutory definition provided by Congress in § 3402(*o*). That court characterized the payments before it as "dismissal pay" subject to FICA tax. *Id.*

By contrast, we resolve the tension between the statutory enactments and the IRS revenue rulings in favor of the expressed will of the legislature. Applying the five-part definition that Congress enacted in § 3402(*o*)(2)(A), the payments made by Quality Stores to its former employees qualify as SUB payments, not "dismissal pay."

And as we have explained, SUB payments are not subject to FICA tax.

We decline to imbue the IRS revenue rulings and private letter rulings with greater significance than the congressional intent expressed in the applicable statutes and legislative histories. Congress, not the IRS, prescribes the tax laws; IRS revenue rulings "have only such force as Congress chooses to give them, and Congress has not given them the force of law." *Dixon v. United States*, 381 U.S. 68, 73, 85 S. Ct. 1301, 14 L. Ed. 2d 223 (1965); *Aeroquip-Vickers, Inc. v. Comm'r of Internal Revenue*, 347 F.3d 173, 181 (6th Cir. 2003) (observing we do not give *Chevron* deference to revenue rulings because "the IRS does not invoke its authority to make rules with the force of law"). The power of the IRS to "administer a federal statute and to prescribe rules and regulations to that end is not the power to make law . . . but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute." *Dixon*, 381 U.S. at 74, 85 S. Ct. 1301. The rights of the taxpayer are defined by the statute, which establishes the standard by which such rights must be measured. *Id.* And where a promulgated Treasury regulation has no power to alter a statute Congress enacted, neither does a revenue ruling. *See id.* at 75, 85 S. Ct. 1301. In appropriate circumstances we may give substantial judicial deference to longstanding and reasonable interpretations of IRS regulations and revenue rulings, *Envtl. Def.*, 549 U.S. at 575, 127 S. Ct. 1423, but in this case we conclude, for all the reasons we have discussed, that the IRS has not taken congressional intent fully into account.

IV. CONCLUSION

We agree with the Federal Circuit on one final important point: "We acknowledge that this issue of statutory construction is complex and that the correct resolution of the issue is far from obvious." *CSX Corp.*, 518 F.3d at 1340. While the Supreme Court may ultimately provide us with the correct resolution of these difficult issues under the law as it currently stands, only Congress can clarify the statutes concerning the imposition of FICA tax on SUB payments. Our role is to interpret the statutory law as it presently exists, and we have done that today. Accordingly, the judgment of the district court is AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 10-1563

IN RE QUALITY STORES, INC., ET AL., DEBTORS
UNITED STATES OF AMERICA, APPELLANT

v.

QUALITY STORES, INC., ET AL., APPELLEES

[Filed: Jan. 4, 2013]

ORDER

Before: BOGGS and STRANCH, Circuit Judges; and CARR,[*] District Judge.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehear-

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[*] Hon. James G. Carr, Senior United States District Judge for the Northern District of Ohio, sitting by designation.

ing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

No. 1:09-CV-44

IN RE QUALITY STORES, INC., ET AL., DEBTORS
UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

v.

QUALITY STORES, INC., ET AL., PLAINTIFFS-APPELLEES

Filed: Feb. 23, 2010

OPINION

JANET T. NEFF, District Judge.

This matter is before the Court on appeal from the Bankruptcy Court. Plaintiffs ("Quality Stores") commenced this adversary proceeding against defendant United States, seeking the refund of $1,000,125 in Federal Insurance Contributions Act[1] (FICA) taxes paid with regard to severance payments to former employees. The Bankruptcy Court, the Honorable James D.

[1] 26 U.S.C. §§ 3101-3128.

Gregg, entered a final judgment in favor of plaintiffs, determining that the payments made to the employees pursuant to the severance programs were not "wages" for purposes of FICA taxation. *See Quality Stores, Inc., v. United States* (*In re Quality Stores, Inc.*), 383 B.R. 67 (Bankr. W.D. Mich. 2008). The United States appeals that decision.

I. Facts

This case was submitted to the Bankruptcy Court on stipulated facts ("Stip.Facts") for purposes of the parties' cross-motions for summary judgment. The facts, as set forth by the Bankruptcy Court, are not disputed on appeal:

> [T]he Debtors operated a chain of retail stores specializing in agricultural supplies and related products. During the period preceding the bankruptcy cases (the "Prepetition Period"), the Debtors were forced to close approximately sixty-three stores and nine distribution centers. The Debtors also terminated approximately seventy-five employees at their corporate office during the Prepetition Period.
>
> On October 20, 2001, an involuntary chapter 11 petition was filed against the Debtors. Quality Stores, Inc., answered the involuntary petition and consented to the entry of an order for relief on November 1, 2001. The remaining Debtors also commenced voluntary chapter 11 cases on November 1, 2001. After the petition date (the "Postpetition Period"), the Debtors closed their remaining 311

stores and three distribution centers. The Debtors also terminated all of their remaining employees.

The Debtors made severance payments to employees who were terminated during both the Prepetition and Postpetition Periods. The parties agree that the severance payments were made "pursuant to [severance plans] maintained by the Debtors." (Stip. Facts ¶ 15.) The parties further stipulate that the severance payments were made "because of the employees' involuntary separation from employment," which resulted "directly from a reduction in force or the discontinuance of a plant or operation." (Stip. Facts ¶ 15.) The severance payments were included in the employees' gross income, and the Debtors reported the severance payments as wages on the W–2 forms issued to employees. The Debtors withheld federal income tax and the employees' share of FICA tax from the severance payments. The Debtors also paid the employer's share of FICA tax with respect to the severance payments.

Under the Prepetition Severance Plan, the Debtors' senior executives received twelve to eighteen months of severance pay. All other employees received one week of severance pay for each full year of service. These payments were not connected to the receipt of state unemployment compensation and were not attributable to the rendering of any particular employment service. The severance payments were paid on a weekly or semi-weekly

basis, in accordance with the Debtors' normal payroll period. Approximately $382,362 of the total refund requested in this adversary proceeding is attributable to severance payments made under the Prepetition Severance Plan.

Under the Postpetition Severance Plan, officers received six to twelve 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 who had worked for the Debtors for less than two years received one week of severance pay, and the approximately 900 employees who were subsequently employed by the companies who purchased the Debtors' assets did not receive any severance pay. Like the prepetition severance payments, the postpetition payments were not connected to the receipt of state unemployment compensation and were not attributable to the rendering of any particular employment services. All severance payments for the Postpetition Period were paid in a lump sum. Approximately $617,763 of the total refund requested in this adversary proceeding is attributable to payments made under the Postpetition Severance Plan.

On September 17, 2002, the Debtors filed fifteen separate refund claims with the IRS, seeking to re-

cover $1,000,125 in allegedly overpaid FICA taxes.[2] On June 1, 2005, the Debtors filed this adversary proceeding. The Debtors' complaint seeks to compel the IRS to turn over the alleged overpaid FICA taxes, plus interest, as property of the Debtors' bankruptcy estate. Because the issue presented in this adversary proceeding is a purely legal question, the parties filed stipulated facts and cross motions for summary judgment. Legal memoranda were filed, oral argument was held, and the court took the matter under advisement.

II. Issue and Legal Rulings

This case presents a straightforward, but legally-confounding question: whether severance payments qualify as "wages" subject to FICA taxation. As framed by the United States, the more specific issue is whether the debtor is liable for FICA taxes on payments to employees upon their termination of employment because of the downsizing and subsequent closing of operations by their employer, even though the payments are not connected to or contingent on the recipients' eligibility for state unemployment compensation benefits (Def. Br. 7).

The few courts that have addressed this issue, or variations of it, have reached directly opposing outcomes. Where one court has found severance pay-

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n. 2 This amount includes the employer's share of FICA taxes paid by the Debtors and the employees' share of FICA taxes for those employees who consented to permit the Debtors to make the refund request on their behalf.

ments to be subject to taxation, the next has reached the opposite conclusion. The fact that the Internal Revenue Service has itself charted a path of "reverse-course" rulings on this issue since the 1950s only adds to the difficulties faced by the courts in attempting to reach a reasoned resolution by explaining and accounting for this repeated change in agency position.

To say that these differing rulings are simply the product of results-oriented decision-making is tempting, but unsupportable. The courts have not only diligently wrestled with the justification for their conclusions, but also endeavored to fashion some appropriate, logical framework for the analysis of this issue.

After a thorough consideration of the parties' arguments, the Bankruptcy Court concluded that the severance payments made to the employees pursuant to the Pre- and Postpetition Severance programs were not "wages" for purposes of FICA taxation. *Quality Stores,* 383 B.R. at 78. The Bankruptcy Court relied in part on the analysis and resolution of this same legal question by the Federal Court of Claims in *CSX Corp., Inc. v. United States,* 52 Fed. Cl. 208 (Fed. Cl. 2002). After the decision by the Bankruptcy Court, however, the United States Court of Appeals for the Federal Circuit reversed, in key part, the lower court's decision in *CSX. See CSX Corp. v. United States,* 518 F.3d 1328 (Fed. Cir. 2008). Given the reversal, the United States moved for reconsideration of the Bankruptcy Court's decision in this case. The Bankruptcy Court granted the motion for reconsideration, and on reconsideration, ratified its prior opinion and order.

Having now the benefit of these courts' prior efforts and analysis, this Court concludes that the severance payments at issue are not properly classified as "wages," and therefore, are not subject to FICA taxation. Accordingly, the decision of the Bankruptcy Court is affirmed.

III. Standard of Review

This case was before the Bankruptcy Court on the parties' cross-motions for summary judgment. The Bankruptcy Court granted summary judgment in favor of Quality Stores. On appeal to this Court from a bankruptcy court's final order or judgment, the bankruptcy court's conclusions of law are reviewed de novo. *Pierce v. Underwood,* 487 U.S. 552, 557-58, 108 S. Ct. 2541, 101 L. Ed. 2d 490 (1988); *In re Rowell,* 359 F. Supp. 2d 645, 647 (W.D. Mich. 2004). Issues of statutory interpretation are questions of law, and are thus subject to review de novo. *ITT Indus. v. Borg-Warner, Inc.,* 506 F.3d 452, 457 (6th Cir. 2007). The district court may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings. FED. R. BANKR. P. 8013.

Federal Rule of Civil Procedure 56 governs summary judgment in bankruptcy court adversary proceedings. FED. R. BANKR. P. 7056; *In re Rowell,* 359 F. Supp. 2d at 647. Thus, the motion for summary judgment is properly granted "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any

material fact and that the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(c).

IV. Analysis

The essential issue presented is whether the severance payments to employees/former employees of Quality Stores constitute taxable "wages" for purposes of FICA. There is no dispute that if the severance payments constitute "wages" for purposes of FICA, and if there is no applicable exception, then the severance payments are subject to FICA taxation, and neither Quality Stores nor the employees is entitled to a refund of the FICA taxes paid.

A. FICA Wages and Exceptions

1. Statutory Provisions

The United States contends that the severance payments at issue are "wages" for purposes of FICA and that no statutory exception applies to exclude them from taxation. Further, the payments do not qualify under the "supplemental unemployment benefits" exception set forth in guidance from the Internal Revenue Service because the severance payments were not conditioned on eligibility for or receipt of state unemployment benefits. *See* Rev. Rul. 90-72, 1990-2 C.B. 211; Rev. Rul. 56-249, 1956-1 C.B. 488. The United States contends therefore, that as a matter of law, the severance payments are subject to FICA taxation, and statutory provisions concerning the withholding of income tax under 26 U.S.C. § 3402(*o*) cannot be relied on

to except the payments from the broad definition of wages under FICA.

"FICA, codified in Chapter 21 of the Internal Revenue Code, Sections 3101 through 3128, imposes a tax upon the wages of employees to fund Social Security and Medicare Benefits." *Appoloni v. United States,* 450 F.3d 185, 189 (6th Cir. 2006). For purposes of FICA, "wages" are defined as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3121(a); *Appoloni,* 450 F.3d at 189-90. "Employment" is defined as "any service, of whatever nature, performed [] by an employee for the person employing him. . . . " 26 U.S.C. § 3121(b).

Section 3121 sets forth statutory exceptions to FICA's broad definition of wages, none of which are at issue here. However, the Internal Revenue Service has also published guidance based on its interpretation of the statute, which provides an exception to FICA for certain payments made by an employer, conditioned on eligibility for and receipt of state unemployment benefits, referred to as "supplemental unemployment compensation benefits," or "SUB" pay. It is this agency exception that is the United States' argument.

2. Revenue Rulings

In a series of revenue rulings from 1956 to 1990, the IRS addressed whether payments from severance plans purporting to be SUB plans constituted "wages" under Chapter 21 (FLCA) and Chapter 24 (income tax

withholding) of the Internal Revenue Code. *See CSX Corp.,* 518 F.3d at 1334-40 (detailing the chronology and nature of the various rulings). Over the course of these rulings, the IRS has reversed its position on the tax treatment of supplemental unemployment compensation benefits.

"In 1956, the Internal Revenue Service issued a revenue ruling, Rev. Rul. 56-249, 1956-1 C.B. 488, in which the IRS took the position with respect to a particular SUB plan that SUB payments under that plan would not be considered 'wages' for purposes of FICA" *CSX Corp.,* 518 F.3d at 1335. The IRS issued additional rulings over the next several years. *Id.* In 1977, the IRS issued a revenue ruling dealing with SUB payments, again specifically determining that SUB payments were not "wages" for purposes of FICA and FUTA. *Id.* at 1337-38. "During the years between 1977 and 1990, the IRS issued a number of private letter rulings in which it approved various SUB plans, authorizing the employers to treat the SUB payments under those plans as non-wages." *Id.* at 1339. In 1989, the IRS announced that it would cease the issuance of private letter rulings concerning SUB payments pending further review of the issue. *Id.*

In 1990, the IRS issued Rev. Rul. 90-72. In this most recent guidance, the IRS concluded that SUB pay must be linked to the receipt of state unemployment compensation and must not be received in a lump sum in order to be excludable from the definition of wages for purposes of FICA taxation and federal income tax withholding. Rev. Rul. 90-72, 1990-2 C.B.

211; *CSX Corp.*, 518 F.3d at 1339-40. "The IRS characterized Rev. Rul. 90-72 as 'restor[ing] the distinction between SUB pay and dismissal pay by re-establishing the link between SUB pay and state unemployment compensation' originally established in Rev. Rul. 56-249, 1990-2 C.B. at 213. As such, the 1990 revenue ruling stated that it was modifying the 1977 revenue ruling to the extent that the earlier ruling had allowed payments to qualify as SUB for purposes of FICA even when the payments were not tied to eligibility for state unemployment compensation." *CSX Corp.*, 518 F.3d at 1340.

3. 26 U.S.C. § 3402(*o*)

"During the 1960s, 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 withholding statutes or FICA." *CSX Corp.*, 518 F.3d at 1336. Because SUB pay was not automatically subject to taxation as wages, and therefore, income tax withholding, employees who received SUB payments often encountered large income tax obligations at the end of the taxable year. *Id.* In 1969, at the request of the Treasury Department, Congress amended Chapter 24 of the Internal Revenue Code (income tax withholding statutes) to solve the problem of 'under withholding' faced by taxpayers who received SUB pay. *Id.* The new tax withholding provision, 26 U.S.C. § 3402(*o*), ensured that SUB payments that were not deemed wages would be subject to income tax withholding by the employer. *Id.*

Section 3402(*o*) provides for income tax withholding on certain payments other than wages, including "any supplemental unemployment compensation," and certain annuity payments and sick pay. At the time of the enactment of § 3402(*o*), the Senate Committee report recognized that SUB payments were not subject to income tax withholding because "'because they do not constitute wages or remuneration for services.'" *CSX Corp.*, 518 F.3d at 1336-37 (quoting S. Rep. No. 91-552, at 268 (1969), *as reprinted in* 1969 U.S.C.C.A.N. 2007, 2305). Accordingly, the amendment added language expressly stating the SUB payments "shall be treated as if it were a payment of wages by an employer to an employee for a payroll period."

Section 3402(*o*) provides:

> 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.

For purposes of paragraph (1), § 3402(*o*) defines "supplemental unemployment compensation benefits" 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 (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.

26 U.S.C. § 3402(*o*)(2)(A).

Although § 3402(*o*) is contained within the income tax withholding statutes, it arguably informs the determination whether SUB payments are "wages" for purposes of FICA tax. "Congress chose 'wages' as the base for measuring employers' obligations under FICA, FUTA, and income-tax withholding."[2] *Rowan*

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[2] "Congress defined 'wages' identically in FICA and FUTA, as 'all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash.'" §§ 3121(a) (FICA), 3306(b) (FUTA). For the purpose of income-tax withholding, "Congress defined 'wages' as 'all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash.' § 3401(a)." *Rowan*, 452 U.S. at 250 n.4, 101 S. Ct. 2288.

Cos., Inc. v. United States, 452 U.S. 247, 254, 101 S. Ct. 2288, 68 L. Ed. 2d 814 (1981). In rowan, the Court considered whether Congress intended the term "wages" to have the same meaning for purposes of FICA, FUTA, and income-tax withholding. *Id.* at 254-55, 101 S. Ct. 2288. The Court observed that from an historic perspective, these Acts "reveal a congressional concern for 'the interest of simplicity and ease of administration.'" *Id.* at 255, 101 S. Ct. 2288 (quoting S. Rep. No. 1631, 77th Cong., 2d Sess., 165 (1942) (revenue Act of 1942)). The Court reasoned that Congress chose to base income tax withholding on the same measure, "wages," as taxation under FICA and FUTA, and specified that remuneration for certain services was excepted from "wages." *Id.* at 255-56, 101 S. Ct. 2288.

Consequently, the *Rowan* Court rejected as invalid Treasury Regulations that did not implement the statutory definition of "wages" in a consistent or reasonable manner. *Rowan,* 452 U.S. at 263, 101 S. Ct. 2288. "The plain language and legislative histories of the relevant Acts indicate that Congress intended its definition to be interpreted in the same manner for FICA and FUTA as for income-tax withholding." *Id.*

4. Decoupling Amendment

Following the decision in *Rowan,* Congress amended the Internal Revenue Code to add language to § 3121(a), often referred to as the "decoupling amendment," to allow for regulatory distinctions between ex-

clusions in "wages" for income tax withholding and other taxation purposes:

> 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. . . .

26 U.S.C. § 3121(a).

There is no dispute that the decoupling amendment applies to this case; however, the parties point to no regulations that have been promulgated to distinguish between the "wage" exclusions under consideration. Instead, the parties dispute whether, in light of the decoupling amendment, the reasoning in *Rowan*, remains controlling.

B. Application

The United States argues that the payments made by Quality Stores to its employees are within the scope of § 3121 because the payments were made in connection with employment and were not conditioned on eligibility for state unemployment benefits as required under the exception set forth in Rev. Rul. 90-72. To the contrary, Quality Stores contends 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 an employee" (Pls. Br. 14). Instead, relying on § 3402(*o*), Quality Stores contends

that for income tax withholding purposes, SUB payments are treated *as if they are wages*; thus, the Bankruptcy Court correctly held that the Severance Payments were not subject to FICA taxation.

As the Federal Circuit Court observed in *CSX,* "this issue of statutory construction is complex and [ ] the correct resolution of the issue is far from obvious." *CSX Corp.,* 518 F.3d at 1340. With all due respect to the Federal Circuit and its consideration of the issues, this Court is persuaded that the Bankruptcy Court was correct in rejecting the Federal Circuit's result in this case. Quality Stores' analysis of the issues is convincing, and a contrary result can only be reached by a strained construction of statutes at issue.

As a general matter, "[i]n enacting the FICA provisions, Congress intended to impose FICA taxes on a broad range of employer-furnished remuneration in order to accomplish the remedial purpose of the Social Security Act." *Associated Elec. Coop., Inc. v. United States,* 226 F.3d 1322, 1326 (Fed. Cir. 2000). Nonetheless, this purpose is not unlimited. The 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. That is, 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 benefits makes little sense.

Only when the morass of seeming complex statutory enactments and regulations is considered in these terms do the taxation provisions become a coherent system anchored to the primary purpose of wage-replacement and social benefits. Having considered the parties' arguments and applied the statutory analysis in these terms, this Court is persuaded that the severance payments at issue are properly viewed as wage-replacement social benefits, not taxable remuneration for the employees' services or wages. Therefore, the severance payments are not subject to taxation for FICA purposes.

For purposes of FICA, "wages" are defined as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3121(a); *Appoloni,* 450 F.3d at 189-90. "Employment" is defined as "any service, of whatever nature, performed [ ] by an employee for the person employing him. . . . " 26 U.S.C. § 3121(b). However, under § 3402(*o*), "any supplemental unemployment compensation" is specifically excluded from the definition of "wages" for tax withholding purposes. As noted above, at the time of the enactment of § 3402(*o*), the Senate Committee report recognized that SUB payments were not subject to income tax withholding because "'because they do not constitute wages or remuneration for services.'" *CSX Corp.,* 518 F.3d at 1336-37.

Section 3402(*o*) defines "supplemental unemployment compensation benefits" 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 (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 employees gross income.

26 U.S.C. § 3402(*o*)(2)(A). Section 3402(*o*) expressly provides that supplemental unemployment compensation benefits, SUB pay, "shall be treated as if it were a payment of wages by an employer to an employee for a payroll period." 26 U.S.C. § 3402(*o*)(1).

The severance payments in this case meet the definition of "supplemental unemployment compensation benefits" in § 3402(*o*)(2). Contrary to the United States' argument, this Court finds no basis for concluding that § 3402(*o*) does not control the determination whether the severance payments at issue in this case are taxable for purposes of FICA. The reasoning in *Rowan* is instructive on this issue. The statutory definition of "wages" must be applied in a consistent or reasonable manner. *Rowan,* 452 U.S. at 263, 101 S. Ct. 2288. There is no justification for differing interpretations of "wages" under FICA and the income tax withholding statutes.

Although following *Rowan*, Congress has provided for regulatory distinctions in "wages," pursuant to the

decoupling amendment, no such regulations have been promulgated to distinguish between the "wage" exclusions under consideration. As Quality Stores points out, Revenue Rulings do not have the effect of regulations. Thus, the Revenue Rulings, and in particular Rev. Rul. 90-72, relied on by the United States do not, pursuant to the decoupling amendment, mandate differing treatment of supplemental unemployment compensation benefits under FICA and the income tax withholding statutes, i.e., § 3402(*o*). Accordingly, despite the decoupling amendment, the reasoning in *Rowan* remains controlling, and Rev. Rul. 90-72 does not override the specific provisions of § 3402(*o*).

> Having determined that § 3402(*o*) properly guides consideration of the severance payments in this case, the Court briefly addresses the Federal Circuit decision in *CSX* in which the court dismissed § 3402(*o*) as ultimately having no bearing on treatment of severance payments. *CSX Corp.*, 518 F.3d at 1341-42. The Federal Circuit concluded that the language in § 3402(*o*) expressly stating that SUB pay "shall be treated *as if it were a payment of wages* by an employer to an employee for a payroll period" does not necessarily imply that no such payments are in fact wages. *Id.* at 1342 (emphasis added).

The Federal Circuit reasoned as follows:

> To 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. Moreover, 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. In sum, the inference that CSX seeks to draw from the statutory language is simply too strained. Thus, while some supplemental unemployment benefit payments do not constitute "wages," it does not follow that all payments fitting within the broad definition of SUB in section 3402(*o*)(2)(A) are non-wages.[3] We therefore conclude that the text of section 3402(*o*) does not require that FICA be interpreted to exclude from "wages" all payments that would satisfy the definition of SUB in section 3402(*o*)(2)(A).

CSX Corp., 518 F.3d at 1342 (footnote omitted).

With all due respect to the Federal Circuit, it is the above analogy to six-feet tall men that strains logic and effectively ignores clear statutory provisions. If 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. The 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. That is, in the context of the above analogy, there is no need for an express statement that all men who *are* six-feet tall shall be treated *as if* they are six-feet tall. 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.

Accordingly, this Court agrees with the Bankruptcy Court that the Federal Circuit's decision in *CSX* does not undermine the reasoning or initial result reached by the Bankruptcy Court concerning the severance payments in this case.

V. Conclusion

"Congress, by enacting FICA, intended to impose FICA taxes on a broad range of remuneration in order to accomplish the remedial purposes of the Social Security Act." *Appoloni,* 450 F.3d at 190 (citing H.R. Rep. No. 74-615, at 3 (1935) (describing the aims of the Social Security Act)). The limits on taxation, however, are not boundless, as Congress has made clear in numerous statutory exceptions to FICA and FUTA taxation. This case involves severance payments "made 'because of the employees' involuntary separation from employment,' which resulted 'directly from a reduction

in force or the discontinuance of a plant or operation.'" *Quality Stores,* 383 B.R. at 69 (citing Stip. Facts ¶ 15). The severance payments thus fall within the § 3402(*o*)(2) exception to wages for "supplemental unemployment compensation benefits." The severance payments are not taxable for purposes of FICA taxation, and the Bankruptcy Court did not err in so determining. The decision of the Bankruptcy Court is therefore affirmed.

An Order consistent with this Opinion will be entered.

APPENDIX D

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

Bankruptcy No. GG 01-10662
Adversary No. 05-80573
QUALITY STORES, INC., ET AL., PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

Filed: Mar. 3, 2008

OPINION REGARDING SEVERENCE PAY AND FICA CONTRIBUTIONS

JAMES D. GREGG, Chief Judge.

I. *INTRODUCTION*

Employees of Quality Stores, Inc., et al. ("Debtors") received severance pay resulting from their involuntary termination from employment because of business cessation. The money received, without question, constitutes "income" within the meaning of the Internal Revenue Code. The question is whether the receipt of the severance pay by the employees constitutes "wages" as well. "Income" and "wages" are not coterminous. Under the facts of this case, where is

the legal boundary line between "income" and "wages" to be drawn?

II. *ISSUE*

Are the Debtors entitled to a turnover from the United States of America, Internal Revenue Service ("IRS") of payments made for Federal Insurance Contributions Act ("FICA") taxes attributable to severance payments made to the Debtors' employees?[1]

III. *JURISDICTION*

The court has subject matter jurisdiction over this bankruptcy case and this adversary proceeding. 28 U.S.C. § 1334. The case and all related proceedings have been referred to this court for decision. 28 U.S.C. § 157(a) and L.R. 83.2(a) (W.D. Mich.). This adversary proceeding is a core proceeding. 28 U.S.C. § 157(b)(2)(E) (turnover of property of the estate).

IV. *FACTS*

The parties have stipulated to the relevant facts for purposes of this summary judgment motion ("Stip. Facts"). Prior to their bankruptcy cases, the Debtors operated a chain of retail stores specializing in agricultural supplies and related products. During the period preceding the bankruptcy cases (the "Prepetition Period"), the Debtors were forced to close approximately sixty-three stores and nine distribution cen-

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[1] This court freely acknowledges it is not an expert in tax law. At oral argument, both parties advised the court, regardless of its decision, this decision will be reviewed by the higher courts.

ters. The Debtors also terminated approximately seventy-five employees at their corporate office during the Prepetition Period.

On October 20, 2001, an involuntary chapter 11 petition was filed against the Debtors. Quality Stores, Inc., answered the involuntary petition and consented to the entry of an order for relief on November 1, 2001. The remaining Debtors also commenced voluntary chapter 11 cases on November 1, 2001. After the petition date (the "Postpetition Period"), the Debtors closed their remaining 311 stores and three distribution centers. The Debtors also terminated all of their remaining employees.

The Debtors made severance payments to employees who were terminated during both the Prepetition and Postpetition Periods. The parties agree that the severance payments were made "pursuant to [severance plans] maintained by the Debtors." (Stip. Facts ¶ 15.) The parties further stipulate that the severance payments were made "because of the employees' involuntary separation from employment," which resulted "directly from a reduction in force or the discontinuance of a plant or operation." (Stip. Facts ¶ 15.) The severance payments were included in the employees' gross income, and the Debtors reported the severance payments as wages on the W-2 forms issued to employees. The Debtors withheld federal income tax and the employees' share of FICA tax from the severance payments. The Debtors also paid the employer's share of FICA tax with respect to the severance payments.

Under the Prepetition Severance Plan, the Debtors' senior executives received twelve to eighteen months of severance pay. All other employees received one week of severance pay for each full year of service. These payments were not connected to the receipt of state unemployment compensation and were not attributable to the rendering of any particular employment service. The severance payments were paid on a weekly or semiweekly basis, in accordance with the Debtors' normal payroll period. Approximately $382,362 of the total refund requested in this adversary proceeding is attributable to severance payments made under the Prepetition Severance Plan.

Under the Postpetition Severance Plan, officers received six to twelve 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 who had worked for the Debtors for less than two years received one week of severance pay, and the approximately 900 employees who were subsequently employed by the companies who purchased the Debtors' assets did not receive any severance pay. Like the prepetition severance payments, the postpetition payments were not connected to the receipt of state unemployment compensation and were not attributable to the rendering of any particular employment services. All severance payments for the Postpetition Period were paid in a lump sum. Approximately $617,763 of

the total refund requested in this adversary proceeding is attributable to payments made under the Postpetition Severance Plan.

On September 17, 2002, the Debtors filed fifteen separate refund claims with the IRS, seeking to recover $1,000,125 in allegedly overpaid FICA taxes.[2] On June 1, 2005, the Debtors filed this adversary proceeding. The Debtors' complaint seeks to compel the IRS to turn over the alleged overpaid FICA taxes, plus interest, as property of the Debtors' bankruptcy estate. Because the issue presented in this adversary proceeding is a purely legal question, the parties filed stipulated facts and cross motions for summary judgment. Legal memoranda were filed, oral argument was held, and the court took the matter under advisement.

V. *DISCUSSION*

A. *Summary Judgment Standard*

Motions for summary judgment are governed by Federal Rule of Civil Procedure 56(c). FED. R. BANKR. P. 7056. Under Rule 56(c), summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the

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[2] This amount includes the employer's share of FICA taxes paid by the Debtors and the employees' share of FICA taxes for those employees who consented to permit the Debtors to make the refund request on their behalf.

moving party is entitled to a judgment as a matter of law." FED. R. CIV. P. 56(c). All material facts have been stipulated to by the parties to this adversary proceeding. The parties agree, and this court believes, that the legal issues presented are appropriate for resolution by summary judgment.

B. *Did the Severance Payments to the Debtors' Employees Constitute "Wages"?*

FICA taxes are imposed on employees' "wages" "to fund Social Security and Medicare Benefits." *Appoloni v. United States,* 450 F.3d 185, 189 (6th Cir. 2006), *cert. denied*, — U.S. —, 127 S. Ct. 1123, 166 L. Ed. 2d 891 (2007). For purposes of FICA, § 3121(a) of the Internal Revenue Code defines "wages" as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3121(a).[3] The

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[3] Section 3121 provides, in pertinent part:

(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; except that such term shall not include—

. . .

(2) the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to, or on behalf of, an employee or any of his dependents under a plan or system established by an employer which makes provision for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a

broad, inclusive nature of this definition has been recognized by both the United States Supreme Court and the Sixth Circuit Court of Appeals. *See Social Sec. Bd. v. Nierotko,* 327 U.S. 358, 365-66, 66 S. Ct. 637, 641, 90 L. Ed. 718 (1946); *Gerbec v. United States,* 164 F.3d 1015, 1026 (6th Cir. 1999). A broad interpretation of this definition has also been deemed consistent with

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class or classes of his employees and their dependents), on account of—

(A) sickness or accident disability (but, in the case of payments made to an employee or any of his dependents, this subparagraph shall exclude from the term wages only payments which are received under a workmen's compensation law), or

(B) medical or hospitalization expenses in connection with sickness or accident disability, or . . .

(4) any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made by an employer to, or on behalf of, an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer,

(5) any payment made to, or on behalf of, an employee or his beneficiary—

. . .

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a),

. . .

(D) under or to an annuity contract described in section 403(b), other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise). . . .

26 U.S.C. § 3121(a).

Congress's intent "to impose FICA taxes on a broad range of remuneration in order to accomplish the remedial purposes of the Social Security Act." *Appoloni,* 450 F.3d at 190 (citation omitted).

An employee's "wages" are also the basis for measuring an employer's obligations under the income tax withholding provisions of the Internal Revenue Code. *Rowan Cos. v. United States,* 452 U.S. 247, 254, 101 S. Ct. 2288, 2293, 68 L. Ed. 2d 814 (1981). For income tax withholding purposes, Congress choose to define the term "wages" in "substantially the same language that it used in FICA. . . . " *Rowan,* 452 U.S. at 255, 101 S. Ct. at 2293. Accordingly, the income tax withholding provisions of the Internal Revenue Code define "wages" as "all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3401(a).

In the income tax context, § 3402(*o*) extends the withholding requirement to "certain payments *other than* wages" including (1) "any supplemental unemployment compensation benefit paid to an individual;" (2) certain annuity payments to an individual; and (3) certain payments of sick pay to an individual. 26 U.S.C. § 3402(*o*) (emphasis added). Section 3402(*o*)(1) states that each of these types of payments shall be "treated *as if it were a payment of wages*" for income tax withholding purposes.[4] 26 U.S.C.

[4] Section 3402(*o*)(1) provides:

§ 3402(*o*)(1) (emphasis added). The Internal Revenue Code defines "supplemental unemployment compensation benefits" 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 (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 employees gross income.

26 U.S.C. § 3402(*o*)(2)(A). In this adversary proceeding, the Debtors and the IRS have stipulated that the severance payments made under both the Pre- and Post-petition Severance Plans meet this definition. (Stip. Facts ¶ 15.)

The Debtors assert that supplemental unemployment compensation benefits are not wages for income

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> (1) General rule.—For purposes of 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 . . . , if at the time the payment is made a request that 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. 26 U.S.C. § 3402(*o*)(1).

tax withholding purposes, but in accordance with § 3402(*o*), are merely treated *as if they were wages.* As additional support for this proposition, the Debtors examine the legislative history of § 3402(*o*). The Senate report explained that supplemental unemployment compensation benefits were not subject to withholding under prior law "because they [did] not constitute wages or remuneration for services." S. Rep. No. 91-552, at 268 (1969), *reprinted in* 1969 U.S.C.C.A.N. 2027, 2305-06. Section 3402(*o*) makes these payments subject to withholding because "although these benefits are not wages" they are "generally taxable income to the recipient" and "the absence of withholding on these benefits may require a significant final tax payment by the taxpayer receiving them." *Id.*

The Debtors argue that if supplemental unemployment compensation benefits are not wages for purposes of income tax withholding, they are likewise not wages for purposes of FICA taxation. This assertion is anchored upon the United States Supreme Court's decision in *Rowan Cos. v. United States,* 452 U.S. 247, 101 S. Ct. 2288, 68 L. Ed. 2d 814 (1981). In *Rowan,* the Supreme Court considered whether the definition of "wages" under FICA and the Federal Unemployment Tax Act ("FUTA") included the value of meals and lodging provided to employees working on Rowan Companies' offshore oil rigs. Pursuant to the Treasury Regulations in effect at the time, the IRS included the fair value of these meals and lodging in withholding "wages" for purposes of FICA and FUTA, but not

for income tax withholding purposes. The Treasury Regulations prescribed this practice notwithstanding the fact that Congress defined the term "wages" in "substantially identical language for each of these three obligations upon employers." *Rowan,* 452 U.S. at 249, 101 S. Ct. at 2290.

Based on the nearly identical definitions of "wages" in the three statutes, the Supreme Court concluded that "Congress intended 'wages' to mean the same thing under FICA, FUTA, and income-tax withholding." *Rowan,* 452 U.S. at 254, 101 S. Ct. at 2293. According to the Court, the statutory scheme was born out of "congressional concern for 'the interest of simplicity and ease of administration.' " *Rowan,* 452 U.S. at 254, 101 S. Ct. at 2293-94 (citation omitted). The Court found that "[i]t would be extraordinary for a Congress pursuing this interest to intend, without ever saying so, for identical definitions to be interpreted differently." *Rowan,* 452 U.S. at 257, 101 S. Ct. at 2294. Therefore, the Court held that the Treasury Regulations were invalid, because they "fail[ed] to implement the statutory definition of 'wages' in a consistent or reasonable manner." *Rowan,* 452 U.S. at 263, 101 S. Ct. at 2298.

The arguments proffered by the Debtors in this adversary proceeding were thoroughly analyzed and accepted by the United States Court of Federal Claims in a recent opinion, *CSX Corp. v. United States,* 52 Fed. Cl. 208 (Fed. Cl. 2002). *CSX* involved an almost identical issue to the one presented in this adversary proceeding, i.e., whether payments made by the em-

ployer under a reduction in force program constituted "wages" for purposes of FICA taxation.[5] Relying 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 holding in *Rowan,* the *CSX* court concluded that FICA taxes did not apply to the payments. The court explained:

> [P]ayments that are nonwage payments from the start are beyond FICA taxation as much as they are beyond income-tax withholding.
>
> ———
>
> Since supplemental unemployment compensation benefits "do not constitute wages or remuneration for services" . . . their taxation under FICA would require their specific inclusion in § 3121(a). And because there is no specific inclusion of supplemental unemployment compensation benefits in § 3121(a), no FICA taxes apply to such payments.

CSX Corp., 52 Fed. Cl. at 215-16 (internal citation omitted).

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[5] *CSX* also addressed whether the reduction in force payments were "compensation" under the Railroad Retirement Tax Act ("RRTA"). *See* 26 U.S.C. §§ 3201-3202 and 3231-3233. The RRTA's definition of "compensation" is essentially identical to FICA's definition of "wages." *Compare* 26 U.S.C. § 3121(a) *with* 26 U.S.C. § 3231(e).

In reaching this conclusion, the *CSX* court rejected many of the same arguments raised by the IRS in this adversary proceeding. This court will address each of the IRS's arguments in turn.

1. *Decoupling Amendment*

First, the IRS argues that Congress explicitly rejected the holding in *Rowan* when it enacted the Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65 (1983). According to the IRS, these amendments contain a "decoupling" provision that specifically rejects *Rowan's* conclusion that wages should be defined the same for purposes of income tax withholding and FICA taxation. The "decoupling" amendment 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.

26 U.S.C. § 3121(a). The IRS argues that the legislative history of the "decoupling" amendment further illustrates Congress's rejection of the holding in *Rowan.* For instance, the Senate Report explains:

> [T]he committee believes that amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion.
>
> . . . .

> The bill provides that . . . the determination of whether or not amounts are includible in the social security wage 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.

S. Rep. No. 98-23, at 42 (1983), *reprinted in* 1983 U.S.C.C.A.N. 143, 183.[6]

As noted by the *CSX* court, the IRS's argument on this point has some superficial appeal. The court explained that by enacting the "decoupling" amendment "Congress has indeed gone on record as saying

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[6] The IRS asserts that the *CSX* court erred by not according more weight to the Congress's intent as expressed in this legislative history to the "decoupling" amendment. However, it is well-settled that "[w]hen interpreting a statute, courts must first consider the plain language of the statute, and resort to a review of congressional intent or legislative history only when the language of the statute is not clear." *QSI Holdings, Inc. v. Alford*, 382 B.R. 731, 737, 2007 WL 4557855 *3 (W.D. Mich. 2007) (citing *In re Comshare, Inc. Sec. Litigation*, 183 F.3d 542, 549 (6th Cir. 1999)); *see United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241, 109 S. Ct. 1026, 1030, 103 L. Ed. 2d 290 (1989) (when a "statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'") (citation omitted). Here, the statutes are not ambiguous. Therefore, the *CSX* court properly declined to "draw upon the legislative history of the decoupling provision' to establish a distinction between wages for FICA purposes and wages for income-tax purposes despite the absence of any law, expressed either in statute or regulation, creating such a distinction." *CSX Corp.*, 52 Fed. Cl. at 214 n.7.

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." *CSX Corp.,* 52 Fed. Cl. at 213. However, the *CSX* court ultimately rejected the IRS's argument, finding that the "decoupling" amendment enacted by Congress to facilitate differentiation between income tax withholding and FICA taxation "is not self-executing." *Id.* Rather, "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.* Without such regulations, there is "no basis for distinguishing between the content of the term 'wages' for income-tax withholding purposes and the content of that term for FICA-tax withholding purposes. Simply put, the holding of *Rowan* remains in place." *Id.; see also HB & R, Inc. v. United States,* 229 F.3d 688, 692 (8th Cir. 2000) (noting that "Congress 'decoupled' the definition of wages for income and FICA tax purposes to allow the Commissioner to promulgate regulations providing different withholding exclusions. . . . "); *Anderson v. United States,* 929 F.2d 648, 653 n.10 (Fed. Cir. 1991) (opining, in dicta, that the "decoupling" amendment provides "for treating 'wages' in both statutes differently, but only through exclusions promulgated by regulation").

This court agrees with the *CSX* opinion. The "decoupling" amendment overrules *Rowan* to the extent that it gives the IRS the ability to define "wages" dif-

ferently for income and FICA tax purposes through valid regulations. However, *Rowan's* more narrow holding—that, as a threshold matter, the term "wages" should be interpreted the same for FICA and income tax withholding purposes—remains binding. This court therefore rejects the IRS's argument that the "decoupling" amendment supersedes the Supreme Court's decision in *Rowan.*

2. *The Revenue Rulings*

The IRS is unable to point to any regulation that would require the severance payments to be treated differently for FICA purposes than they are for income tax withholding purposes. The IRS argues, however, that it has established a limited exception to FICA's definition of "wages" for certain payments made upon an employee's separation from the employer's service. The IRS maintains that this limited exception was promulgated through a series of revenue rulings, "culminating in Rev. Rul. 90-72, 1990-2 C.B. 211." (Dft. Brief at 9.) According to the IRS, this exception only applies if: (1) the employee was involuntarily separated from service due to a plant closing, layoff, or reduction in force; (2) the employee also received state unemployment compensation; (3) the supplemental unemployment compensation payment was not received as a lump sum. The parties have stipulated that the payments at issue in this adversary proceeding do not meet these criteria. (Stip. Facts ¶ 21, 27 & 28.)

Revenue rulings do not have the binding force of statutory provisions or the presumption of correctness of the regulations. *See Appoloni v. United States*, 450 F.3d 185, 194 (6th Cir. 2006), cert. denied, — U.S. —, 127 S. Ct. 1123, 166 L. Ed. 2d 891 (2007) (citing *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S. Ct. 161, 164, 89 L. Ed. 124 (1944)); *Aeroquip-Vickers, Inc. v. Comm'r*, 347 F.3d 173, 181 (6th Cir. 2003) (noting that "the IRS does not invoke its authority to make rules with the force of law" when it issues revenue rulings). However, some varying degree of deference to revenue rulings is required. [T]he level of deference to be accorded to [revenue rulings] depends upon "the thoroughness evident in [the ruling's] consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade. . . ." *Aeroquip-Vickers, Inc.*, 347 F.3d at 181; *see Appoloni*, 450 F.3d at 194. Applying this standard to Rev. Rul. 90-72, the court opines that the ruling is not entitled to persuasive deference.

First, the IRS's treatment of "supplemental unemployment compensation benefits" has not been very consistent over time. *See, e.g.*, Rev. Rul. 56-249, 1956-1 C.B. 488, 492 (first establishing a limited exception from the FICA, FUTA, and income tax withholding definition of "wages" for certain payments made to an employee upon his or her involuntary separation from employment; the ruling set forth eight criteria that must be met for payments to qualify for this exception); Rev. Rul. 58-128, 1958-1 C.B. 89 (broadening

and clarifying the scope of Rev. Rul. 56-249); Rev. Rul. 60-330, 1960-2 C.B. 46, Rev. Rul. 71-408, 1971-2 C.B. 340; Rev. Rul. 77-347, 1977-2 C.B. 362 (reversing course, and stating that benefits did not be tied to the receipt of state unemployment benefits to be considered supplemental unemployment compensation benefits for purposes of FICA, FUTA and income tax withholding); Rev. Rul. 90-72, 1990-2 C.B. at 212 (stating that "[t]he portion of Rev. Rul. 77-347 concluding that benefits do not have to be linked to state unemployment compensation in order to be excluded from the definition of wages for FICA and FUTA tax purposes is inconsistent with the underlying premises for the exclusion and is therefore hereby revoked").

More importantly, the revenue ruling relied upon by the IRS, 90-72, offers no cogent explanation for its overly broad conclusion that "the definition of [supplemental unemployment compensation benefits] under section 3402(*o*) is not applicable for FICA or FUTA purposes." 1990-2 C.B. at 211-12. In the absence of such analysis, this court is unable to ignore or downplay the plain language of §§ 3121(a) and 3402(*o*) and *Rowan's* admonition that the income tax and FICA provisions are to be interpreted and applied consistently.

3. *Statutory Exclusions from FICA Definition of "Wages"*

The IRS's third argument arises from differences in the statutory exclusions under the income tax withholding scheme, § 3402(*o*), and the FICA provisions,

§ 3121(a). The IRS notes that only two of the three types of payments "treated as wages" for income tax purposes—i.e., annuity payments and sick pay, but not supplemental unemployment compensation benefits—are also specifically excluded from FICA wages under § 3121(a). According to the IRS, it was unnecessary for Congress to exclude annuity payments and sick pay from FICA's definition of "wages" if all three of the items referred to in § 3402(*o*), including supplemental unemployment compensation benefits, were already considered non-wage payments for purposes of FICA.

As the *CSX* 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. For instance, annuity payments are considered "remuneration for services" and are thus deemed "wages" for purposes of both FICA and income tax withholding. Nonetheless, these payments are specifically excluded from the definition of "wages" under the two statutes. By enacting § 3402(*o*), Congress gave employees the option of requesting that such payments be subject to income tax withholding (i.e., to have the payments "treated as if they were wages"), to help the employee cushion an unexpectedly large tax bill at the year end. Supplemental unemployment compensation benefits, on the other hand, are not considered to be "remuneration for services." Accordingly, 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.

Again, the rationale of the *CSX* court is persuasive: "the absence of an exclusion from the definition of wages for FICA purposes is not determinative of whether a particular payment is subject to FICA taxation." *CSX Corp.,* 52 Fed. Cl. at 216. Instead, "[t]he question that needs to be asked is whether the payment falls outside the definition of wages from the start." *Id.* The taxation of non-wage payments "requires their specific inclusion in the taxing scheme." *id.* at 215 (emphasis in original).

4. *Sixth Circuit Precedent—Appoloni v. United States*

Finally, the IRS asserts that this court should not adopt the "extremely narrow and strained interpretation" of "wages" for purposes of FICA taxation employed by the court in *CSX* because such interpretation is "thoroughly inconsistent" with Sixth Circuit case law which instructs that FICA is to be broadly construed. (Dft. Br. at 15.) The IRS refers to *Appoloni v. United States,* 450 F.3d 185 (6th Cir. 2006), *cert. denied*, — U.S. —, 127 S. Ct. 1123, 166 L. Ed. 2d 891 (2007). The issue in *Appoloni* was whether payments made to public school teachers, who resigned from their positions and relinquished their tenure rights upon receipt of such payments, were taxable "wages" under FICA. *Id.* at 189. Based largely on the eligibility requirements for receipt of the payments, the court held that the payments were remuneration "for services performed" and consequently, were "wages" for purposes of FICA taxation. *Id.* at 191. The court reached this conclusion despite the fact that the

teachers also relinquished tenure rights by accepting the payments. *id*. at 192-95 (rejecting *North Dakota State Univ. v. United States,* 255 F.3d 599 (8th Cir. 2001)). The Sixth Circuit's analysis of the issue also emphasized the "broad, inclusive nature" of FICA's definition of "wages." *Id.* at 190 (citing *Social Security Bd. v. Nierotko,* 327 U.S. 358, 365-66, 66 S. Ct. 637, 641, 90 L. Ed. 718 (1946); *Gerbec v. United States,* 164 F.3d 1015, 1026 (6th Cir. 1999)). The IRS concedes that *Appoloni* is not directly on point, but argues that the decision illustrates the Sixth Circuit's general approach to interpreting the definition of "wages" for purposes of FICA taxation.

This court agrees that *Appoloni* is not directly relevant to the issue presented in this adversary proceeding. Importantly, in contrast to the payments at issue in this adversary proceeding, the payments in *Appoloni* did not qualify as "supplemental unemployment compensation benefits" under § 3402(*o*). Therefore, the facts in *Appoloni* did not require the Sixth Circuit to determine whether "supplemental unemployment compensation benefits" should be deemed "wages" under FICA. Instead, the *Appoloni* court applied the general definition of "wages" to the payments at issue in that case.

However, notwithstanding the different issues discussed, this court believes that *CSX* and *Appoloni* are consistent. After concluding that "supplemental unemployment compensation benefits" were not wages under FICA, the second portion of the *CSX* opinion addressed whether the specific payments at issue in

that case actually qualified as "supplemental employment compensations benefits" under § 3402(*o*). In making this determination, the *CSX* court stated it was "mindful" that FICA was subject to broad interpretation and cited the same precedent relied upon in *Appoloni* for this proposition. *CSX Corp.*, 52 Fed. Cl. at 218 (citing *Nierotko*, 327 U.S. at 366, 66 S. Ct. at 641). The *CSX* court went on to conclude that separation payments to "employees who elect[ed] separation in lieu of remaining in their existing positions" did "not qualify as supplemental unemployment compensation benefits" because those employees were not "involuntarily separated" from their employment. *CSX Corp.*, 52 Fed. Cl. at 220. The *CSX* court held that these separation payments were "wages" despite the fact that the employees relinquished certain rights to receive them. *Id.* at 221 (When "job-related benefits [tike vacation pay, sick pay, layoff pay, seniority or tenure rights] are relinquished in favor of a lump-sum payment, the transaction simply amounts to a redemption, paid in cash, of wage amounts previously paid in kind.") (also rejecting *North Dakota*, 255 F.3d 599). Interestingly, *Appoloni* cited this portion of the *CSX* opinion in its discussion of the effect of relinquishment of tenure rights and expressly agreed with the reasoning employed therein. *Appoloni*, 450 F.3d at 195.

5. *Summary*

Simply stated, this court agrees with the *CSX* opinion. Considering the nearly identical statutory definitions, and under the Supreme Court's decision in *Rowan*, the term "wages" should be interpreted the

same for both FICA and income tax purposes. Because "supplemental unemployment compensation benefits" are not "wages" for purposes of income tax withholding, they are likewise not "wages" under FICA. Although the "decoupling" provision gives the IRS the ability to establish distinctions between the two statutory definitions, such distinctions must be made through the promulgation of valid regulations. No such regulations exist. Accordingly, this court concludes that the payments made to the Debtors' employees pursuant to the Pre- and Postpetition Severance programs are not "wages" for purposes of FICA taxation. The IRS shall refund the overpaid FICA taxes to the Debtors' bankruptcy estate.

VI. *CONCLUSION*

For the reasons stated above, the Debtors' motion for summary judgment is GRANTED and the IRS's cross motion for summary judgment is DENIED. A further hearing shall be scheduled as soon as is practicable to determine the amount of the refund to be turned over, including a calculation of the interest to be paid. A separate order shall enter accordingly.

APPENDIX E

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

Case No. GG 01-10662 (Jointly Administered) Chapter 11
Adversary Proceeding No. 05-80573

IN RE: QUALITY STORES, INC., ET AL., DEBTORS

QUALITY STORES, INC., ET AL., PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed: Aug. 29, 2008]

ORDER GRANTING DEFENDANT'S MOTION FOR RECONSIDERATION AND ORDER RATIFYING PRIOR OPINION AND ORDER

At a session of said court of bankruptcy, held in and for said district, on August 29, *2008.*

PRESENT: HONORABLE JAMES D. GREGG
Chief United States Bankruptcy Judge

On May 16, 2008, the United States of America, Internal Revenue Service ("IRS") filed a Motion to Recon-

sider in the above-captioned adversary. The motion requests that the court reconsider its prior Opinion and Order Regarding Severance Pay and FICA Contributions, dated February 21, 2008. The principal basis for the motion to reconsider is that one case relied upon by this court, *CSX Corp. v. United States*, 52 Fed. Cl. 208 (Fed. Cl. 2002), was partially reversed by the United States Court of Appeals for the Federal Circuit shortly after this court issued its decision. *See CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008). This court has reviewed the Court of Appeals' opinion and, after careful consideration, has determined not to change its prior decision.

NOW, THEREFORE, IT IS HEREBY ORDERED that:

1. The Motion to Reconsider filed by the IRS be, and hereby is, GRANTED.

2. Upon reconsideration, this court's prior Opinion and Order Regarding Severance Pay and FICA Contributions, dated February 21, 2008, be, and hereby are, ratified. The prior order remains valid and binding.

3. A hearing to determine the specific amount of the refund, including interest, to be turned over to Quality Stores, Inc., et al. by the IRS shall be held on **October 16, 2008**, at **1:00 p.m.** in **Grand Rapids**, Michigan.

4. This is NOT a final order.

IT IS FURTHER ORDERED that a copy of this order shall be served by electronic means (ECF) or first-class United States mail, postage pre-paid, upon the following persons:

Janet S. Baer, Esq. (ECF)

Natalie Hoyer Keller, Esq.
Kirkland & Ellis LLP
200 East Randolph Dr
Suite 5500 Chicago, IL 60601

Michael W. Davis, Esq. (ECF)

Michael L. Shiparski, Esq. (ECF)

/s/ JAMES D. GREGG
HONORABLE JAMES D. GREGG
Chief United States Bankruptcy Judge

[SERVED AS ORDERED: S. Combs Aug. 29]

APPENDIX F

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

Bankruptcy No. GG 01-10662
Adversary No. 05-80573

QUALITY STORES[1], INC., ET AL., DEBTOR

QUALITY STORES, INC., ET AL., PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed: Nov. 25, 2008]

FINAL JUDGMENT

Based upon the parties' stipulation and the other materials of record, it is hereby adjudged that Plaintiff, Quality Stores, Inc. et al., shall recover from Defendant,

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[1] The Debtors are the following entities: QSI Holdings, Inc. (f/k/a CT Holdings, Inc.); Quality Stores, Inc. (f/k/a Central Tractor Farm & Country, Inc.); Country General, Inc.; F and C Holding. Inc.; FarmandCountry.com, LLC; QSI Newco, Inc.; QSI Transportation, Inc.; Quality Farm & Fleet, Inc.; Quality Investments, Inc.; Quality Stores Services, Inc.; and Vision Transportation, Inc.

United States of America, the sum of One Million One Hundred and Twenty-Five Dollars ($1,000,125.00), plus interest as provided by law.

The adjudged amount represents a refund of taxes paid per the Federal Insurance Contributions Act ("FICA") for periods ending in the years 1999 through 2002, as requested in Plaintiff's claims for refund, filed on September 17, 2002. The sum of Five Hundred Seventy-One thousand Four Hundred and Five dollars ($571,405.00), plus interest as provided by law, represents the employer portion of the refund, and the sum of Four Hundred Twenty-Eight Thousand Seven Hundred and Twenty Dollars ($428,720.00), plus interest as provided by law, represents the employee portion of the refund. The components of the adjudged amount are further itemized in the exhibits attached to the Complaint, which are incorporated herein by reference.

This is a final judgment for purposes of appeal.

Date: Nov. 25, 2008

/s/ JAMES D. GREGG
HONORABLE JAMES D. GREGG
Chief United States Bankruptcy Judge

Approved as to form:

Date: Nov. 18, 2008

/s/ L. STEVEN SCHIFANO
L. STEVEN SCHIFANO, Trial Attorney
United States Department of Justice

Tax Division, Civil Trial Section,
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Date: Nov. 19, 2008

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Judgment drafted by Attorney Schifano

APPENDIX G

1. 26 U.S.C. 3101 provides:

Rate of tax

(a) Old-age, survivors, and disability insurance

In addition to other taxes, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

In cases of wages received during:	The rate shall be:
1984, 1985, 1986, or 1987	5.7 percent
1988 or 1989	6.06 percent
1990 or thereafter	6.2 percent.

(b) Hospital insurance

In addition to the tax imposed by the preceding subsection, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

(1) with respect to wages received during the calendar years 1974 through 1977, the rate shall be 0.90 percent;

(2) with respect to wages received during the calendar year 1978, the rate shall be 1.00 percent;

(3) with respect to wages received during the calendar years 1979 and 1980, the rate shall be 1.05 percent;

(4) with respect to wages received during the calendar years 1981 through 1984, the rate shall be 1.30 percent;

(5) with respect to wages received during the calendar year 1985, the rate shall be 1.35 percent; and

(6) with respect to wages received after December 31, 1985, the rate shall be 1.45 percent.

(c) Relief from taxes in cases covered by certain international agreements

During any period in which there is in effect an agreement entered into pursuant to section 233 of the Social Security Act with any foreign country, wages received by or paid to an individual shall be exempt from the taxes imposed by this section to the extent that such wages are subject under such agreement exclusively to the laws applicable to the social security system of such foreign country.

2. 26 U.S.C. 3121 (2006 & Supp. V 2011) provides:

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; except that such term shall not include—

(1) in the case of the taxes imposed by sections 3101(a) and 3111(a) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) with respect to employment has been paid to an individual by an employer during the calendar year with respect to which such contribution and benefit base is effective, is paid to such individual by such employer during such calendar year. If an employer (hereinafter referred to as successor employer) during any calendar year acquires substantially all the property used in a trade or business of another employer (hereinafter referred to as a predecessor), or used in a separate unit of a trade or business of a predecessor, and immediately after the acquisition employs in his trade or business an individual who immediately prior to the acquisition was employed in the trade or business of such predecessor, then, for the purpose of determining whether the successor employer has paid remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) to such individual during such calendar year, any remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment paid (or considered under this paragraph as having been paid) to such individual by such predecessor during such

calendar year and prior to such acquisition shall be considered as having been paid by such successor employer;

(2) the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to, or on behalf of, an employee or any of his dependents under a plan or system established by an employer which makes provision for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a class or classes of his employees and their dependents), on account of—

(A) sickness or accident disability (but, in the case of payments made to an employee or any of his dependents, this subparagraph shall exclude from the term "wages" only payments which are received under a workman's compensation law), or

(B) medical or hospitalization expenses in connection with sickness or accident disability, or

(C) death, except that this paragraph does not apply to a payment for group-term life insurance to the extent that such payment is includible in the gross income of the employee;

[(3) Repealed. Pub. L. 98-21, title III, § 324(a)(3)(B), Apr. 20, 1983, 97 Stat. 123]

(4) any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made

by an employer to, or on behalf of, an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer;

(5) any payment made to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust,

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a),

(C) under a simplified employee pension (as defined in section 408(k)(1)), other than any contributions described in section 408(k)(6),

(D) under or to an annuity contract described in section 403(b), other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise),

(E) under or to an exempt governmental deferred compensation plan (as defined in subsection (v)(3)),

(F) to supplement pension benefits under a plan or trust described in any of the foregoing provisions of this paragraph to take into account some

portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement but only if such supplemental payments are under a plan which is treated as a welfare plan under section 3(2)(B)(ii) of the Employee Retirement Income Security Act of 1974,

(G) under a cafeteria plan (within the meaning of section 125) if such payment would not be treated as wages without regard to such plan and it is reasonable to believe that (if section 125 applied for purposes of this section) section 125 would not treat any wages as constructively received,

(H) under an arrangement to which section 408(p) applies, other than any elective contributions under paragraph (2)(A)(i) thereof, or

(I) under a plan described in section 457(e)(11)(A)(ii) and maintained by an eligible employer (as defined in section 457(e)(1));

(6) the payment by an employer (without deduction from the remuneration of the employee)—

(A) of the tax imposed upon an employee under section 3101, or

(B) of any payment required from an employee under a State unemployment compensation law,

with respect to remuneration paid to an employee for domestic service in a private home of the employer or for agricultural labor;

(7)(A) remuneration paid in any medium other than cash to an employee for service not in the course of the employer's trade or business or for domestic service in a private home of the employer;

(B) cash remuneration paid by an employer in any calendar year to an employee for domestic service in a private home of the employer (including domestic service on a farm operated for profit), if the cash remuneration paid in such year by the employer to the employee for such service is less than the applicable dollar threshold (as defined in subsection (x)) for such year;

(C) cash remuneration paid by an employer in any calendar year to an employee for service not in the course of the employer's trade or business, if the cash remuneration paid in such year by the employer to the employee for such service is less than $100. As used in this subparagraph, the term "service not in the course of the employer's trade or business" does not include domestic service in a private home of the employer and does not include service described in subsection (g)(5);

(8)(A) remuneration paid in any medium other than cash for agricultural labor;

(B) cash remuneration paid by an employer in any calendar year to an employee for agricultural labor unless—

(i) the cash remuneration paid in such year by the employer to the employee for such labor is $150 or more, or

(ii) the employer's expenditures for agricultural labor in such year equal or exceed $2,500,

except that clause (ii) shall not apply in determining whether remuneration paid to an employee constitutes "wages" under this section if such employee (I) is employed as a hand harvest laborer and is paid on a piece rate basis in an operation which has been, and is customarily and generally recognized as having been, paid on a piece rate basis in the region of employment, (II) commutes daily from his permanent residence to the farm on which he is so employed, and (III) has been employed in agriculture less than 13 weeks during the preceding calendar year;

[(9) Repealed. Pub. L. 98–21, title III, § 324(a)(3)(B), Apr. 20, 1983, 97 Stat. 123]

(10) remuneration paid by an employer in any calendar year to an employee for service described in subsection (d)(3)(C) (relating to home workers), if the cash remuneration paid in such year by the employer to the employee for such service is less than $100;

(11) remuneration paid to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217 (determined without regard to section 274(n));

(12)(A) tips paid in any medium other than cash;

(B) cash tips received by an employee in any calendar month in the course of his employment by an employer unless the amount of such cash tips is $20 or more;

(13) any payment or series of payments by an employer to an employee or any of his dependents which is paid—

(A) upon or after the termination of an employee's employment relationship because of (i) death, or (ii) retirement for disability, and

(B) under a plan established by the employer which makes provision for his employees generally or a class or classes of his employees (or for such employees or class or classes of employees and their dependents),

other than any such payment or series of payments which would have been paid if the employee's employment relationship had not been so terminated;

(14) any payment made by an employer to a survivor or the estate of a former employee after the calendar year in which such employee died;

(15) any payment made by an employer to an employee, if at the time such payment is made such employee is entitled to disability insurance benefits under section 223(a) of the Social Security Act and such entitlement commenced prior to the calendar year in which such payment is made, and if such employee did not perform any services for such employer during the period for which such payment is made;

(16) remuneration paid by an organization exempt from income tax under section 501(a) (other than an organization described in section 401(a)) or under section 521 in any calendar year to an employee for service rendered in the employ of such organization, if the remuneration paid in such year by the organization to the employee for such service is less than $100;

(17) any contribution, payment, or service provided by an employer which may be excluded from the gross income of an employee, his spouse, or his dependents, under the provisions of section 120 (relating to amounts received under qualified group legal services plans);

(18) any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127, 129, 134(b)(4), or 134(b)(5);

(19) the value of any meals or lodging furnished by or on behalf of the employer if at the time of such furnishing it is reasonable to believe that the employee will be able to exclude such items from income under section 119;

(20) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 108(f)(4), 117, or 132;

(21) in the case of a member of an Indian tribe, any remuneration on which no tax is imposed by this chapter by reason of section 7873 (relating to income derived by Indians from exercise of fishing rights);

(22) remuneration on account of—

(A) a transfer of a share of stock to any individual pursuant to an exercise of an incentive stock option (as defined in section 422(b)) or under an employee stock purchase plan (as defined in section 423(b)), or

(B) any disposition by the individual of such stock; or

(23) any benefit or payment which is excludable from the gross income of the employee under section 139B(b).

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. Except as otherwise provided in regulations prescribed by the Secretary, any third party which makes a payment included in wages solely by reason of the parenthetical matter contained in subparagraph (A) of paragraph (2) shall be treated for purposes of this chapter and chapter 22 as the employer with respect to such wages.

(b) Employment

For purposes of this chapter, the term "employment" means any service, of whatever nature, performed (A) by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States, or (B) outside the United States by a citizen or resident of the United States as an employee for an American employer (as defined in subsection (h)), or (C) if it is service, regardless of where or by whom performed, which is designated as employment or recognized as equivalent to employment under an agreement entered into under section 233 of the Social Security Act; except that such term shall not include—

(1) service performed by foreign agricultural workers lawfully admitted to the United States from the Bahamas, Jamaica, and the other British West Indies, or from any other foreign country or possession thereof, on a temporary basis to perform agricultural labor;

(2) domestic service performed in a local college club, or local chapter of a college fraternity or soror-

ity, by a student who is enrolled and is regularly attending classes at a school, college, or university;

(3)(A) service performed by a child under the age of 18 in the employ of his father or mother;

(B) service not in the course of the employer's trade or business, or domestic service in a private home of the employer, performed by an individual under the age of 21 in the employ of his father or mother, or performed by an individual in the employ of his spouse or son or daughter; except that the provisions of this subparagraph shall not be applicable to such domestic service performed by an individual in the employ of his son or daughter if—

(i) the employer is a surviving spouse or a divorced individual and has not remarried, or has a spouse living in the home who has a mental or physical condition which results in such spouse's being incapable of caring for a son, daughter, stepson, or stepdaughter (referred to in clause (ii)) for at least 4 continuous weeks in the calendar quarter in which the service is rendered, and

(ii) a son, daughter, stepson, or stepdaughter of such employer is living in the home, and

(iii) the son, daughter, stepson, or stepdaughter (referred to in clause (ii)) has not attained age 18 or has a mental or physical condition which requires the personal care and supervision of an adult for at least 4 continuous

weeks in the calendar quarter in which the service is rendered;

(4) service performed by an individual on or in connection with a vessel not an American vessel, or on or in connection with an aircraft not an American aircraft, if (A) the individual is employed on and in connection with such vessel or aircraft, when outside the United States and (B)(i) such individual is not a citizen of the United States or (ii) the employer is not an American employer;

(5) service performed in the employ of the United States or any instrumentality of the United States, if such service—

(A) would be excluded from the term "employment" for purposes of this title if the provisions of paragraphs (5) and (6) of this subsection as in effect in January 1983 had remained in effect, and

(B) is performed by an individual who—

(i) has been continuously performing service described in subparagraph (A) since December 31, 1983, and for purposes of this clause—

(I) if an individual performing service described in subparagraph (A) returns to the performance of such service after being separated therefrom for a period of less than 366 consecutive days, regardless of whether the period began before, on, or after December 31,

1983, then such service shall be considered continuous,

(II) if an individual performing service described in subparagraph (A) returns to the performance of such service after being detailed or transferred to an international organization as described under section 3343 of subchapter III of chapter 33 of title 5, United States Code, or under section 3581 of chapter 35 of such title, then the service performed for that organization shall be considered service described in subparagraph (A),

(III) if an individual performing service described in subparagraph (A) is reemployed or reinstated after being separated from such service for the purpose of accepting employment with the American Institute in Taiwan as provided under section 3310 of chapter 48 of title 22, United States Code, then the service performed for that Institute shall be considered service described in subparagraph (A),

(IV) if an individual performing service described in subparagraph (A) returns to the performance of such service after performing service as a member of a uniformed service (including, for purposes of this clause, service in the National Guard and temporary service in the Coast Guard Reserve) and after exercising restoration or reemployment rights as provided under chapter 43 of title 38, United States Code, then the service so performed as

a member of a uniformed service shall be considered service described in subparagraph (A), and

(V) if an individual performing service described in subparagraph (A) returns to the performance of such service after employment (by a tribal organization) to which section 105(e)(2)[1] of the Indian Self-Determination Act applies, then the service performed for that tribal organization shall be considered service described in subparagraph (A); or

(ii) is receiving an annuity from the Civil Service Retirement and Disability Fund, or benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed service);

except that this paragraph shall not apply with respect to any such service performed on or after any date on which such individual performs—

(C) service performed as the President or Vice President of the United States,

(D) service performed—

(i) in a position placed in the Executive Schedule under sections 5312 through 5317 of title 5, United States Code,

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[1] See References in Text note below.

(ii) as a noncareer appointee in the Senior Executive Service or a noncareer member of the Senior Foreign Service, or

(iii) in a position to which the individual is appointed by the President (or his designee) or the Vice President under section 105(a)(1), 106(a)(1), or 107 (a)(1) or (b)(1) of title 3, United States Code, if the maximum rate of basic pay for such position is at or above the rate for level V of the Executive Schedule,

(E) service performed as the Chief Justice of the United States, an Associate Justice of the Supreme Court, a judge of a United States court of appeals, a judge of a United States district court (including the district court of a territory), a judge of the United States Court of Federal Claims, a judge of the United States Court of International Trade, a judge of the United States Tax Court, a United States magistrate judge, or a referee in bankruptcy or United States bankruptcy judge,

(F) service performed as a Member, Delegate, or Resident Commissioner of or to the Congress,

(G) any other service in the legislative branch of the Federal Government if such service—

(i) is performed by an individual who was not subject to subchapter III of chapter 83 of title 5, United States Code, or to another retirement system established by a law of the United States for employees of the Federal Govern-

ment (other than for members of the uniformed services), on December 31, 1983, or

(ii) is performed by an individual who has, at any time after December 31, 1983, received a lump-sum payment under section 8342(a) of title 5, United States Code, or under the corresponding provision of the law establishing the other retirement system described in clause (i), or

(iii) is performed by an individual after such individual has otherwise ceased to be subject to subchapter III of chapter 83 of title 5, United States Code (without having an application pending for coverage under such subchapter), while performing service in the legislative branch (determined without regard to the provisions of subparagraph (B) relating to continuity of employment), for any period of time after December 31, 1983,

and for purposes of this subparagraph (G) an individual is subject to such subchapter III or to any such other retirement system at any time only if (a) such individual's pay is subject to deductions, contributions, or similar payments (concurrent with the service being performed at that time) under section 8334(a) of such title 5 or the corresponding provision of the law establishing such other system, or (in a case to which section 8332(k)(1) of such title applies) such individual is making payments of amounts equivalent to such deductions, contributions, or similar payments while on leave without

pay, or (b) such individual is receiving an annuity from the Civil Service Retirement and Disability Fund, or is receiving benefits (for service as an employee) under another retirement system established by a law of the United States for employees of the Federal Government (other than for members of the uniformed services), or

(H) service performed by an individual—

(i) on or after the effective date of an election by such individual, under section 301 of the Federal Employees' Retirement System Act of 1986, section 307 of the Central Intelligence Agency Retirement Act (50 U.S.C. 2157), or the Federal Employees' Retirement System Open Enrollment Act of 1997[2] to become subject to the Federal Employees' Retirement System provided in chapter 84 of title 5, United States Code, or

(ii) on or after the effective date of an election by such individual, under regulations issued under section 860 of the Foreign Service Act of 1980, to become subject to the Foreign Service Pension System provided in subchapter II of chapter 8 of title I of such Act;

(6) service performed in the employ of the United States or any instrumentality of the United States if such service is performed—

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[2] So in original. Probably should be followed by a comma.

(A) in a penal institution of the United States by an inmate thereof;

(B) by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of hospitals of the Federal Government), other than as a medical or dental intern or a medical or dental resident in training; or

(C) by any individual as an employee serving on a temporary basis in case of fire, storm, earthquake, flood, or other similar emergency;

(7) service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby, except that this paragraph shall not apply in the case of—

(A) service which, under subsection (j), constitutes covered transportation service,

(B) service in the employ of the Government of Guam or the Government of American Samoa or any political subdivision thereof, or of any instrumentality of any one or more of the foregoing which is wholly owned thereby, performed by an officer or employee thereof (including a member of the legislature of any such Government or political subdivision), and, for purposes of this title with respect to the taxes imposed by this chapter—

(i) any person whose service as such an officer or employee is not covered by a retirement

system established by a law of the United States shall not, with respect to such service, be regarded as an employee of the United States or any agency or instrumentality thereof, and

(ii) the remuneration for service described in clause (i) (including fees paid to a public official) shall be deemed to have been paid by the Government of Guam or the Government of American Samoa or by a political subdivision thereof or an instrumentality of any one or more of the foregoing which is wholly owned thereby, whichever is appropriate,

(C) service performed in the employ of the District of Columbia or any instrumentality which is wholly owned thereby, if such service is not covered by a retirement system established by a law of the United States (other than the Federal Employees Retirement System provided in chapter 84 of title 5, United States Code); except that the provisions of this subparagraph shall not be applicable to service performed—

(i) in a hospital or penal institution by a patient or inmate thereof;

(ii) by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of hospitals of the District of Columbia Government), other than as a medical or dental intern or as a medical or dental resident in training;

(iii) by any individual as an employee serving on a temporary basis in case of fire, storm, snow, earthquake, flood or other similar emergency; or

(iv) by a member of a board, committee, or council of the District of Columbia, paid on a per diem, meeting, or other fee basis,

(D) service performed in the employ of the Government of Guam (or any instrumentality which is wholly owned by such Government) by an employee properly classified as a temporary or intermittent employee, if such service is not covered by a retirement system established by a law of Guam; except that (i) the provisions of this subparagraph shall not be applicable to services performed by an elected official or a member of the legislature or in a hospital or penal institution by a patient or inmate thereof, and (ii) for purposes of this subparagraph, clauses (i) and (ii) of subparagraph (B) shall apply,

(E) service included under an agreement entered into pursuant to section 218 of the Social Security Act, or

(F) service in the employ of a State (other than the District of Columbia, Guam, or American Samoa), of any political subdivision thereof, or of any instrumentality of any one or more of the foregoing which is wholly owned thereby, by an individual who is not a member of a retirement system of such State, political subdivision, or instrumentality, ex-

cept that the provisions of this subparagraph shall not be applicable to service performed—

(i) by an individual who is employed to relieve such individual from unemployment;

(ii) in a hospital, home, or other institution by a patient or inmate thereof;

(iii) by any individual as an employee serving on a temporary basis in case of fire, storm, snow, earthquake, flood, or other similar emergency;

(iv) by an election official or election worker if the remuneration paid in a calendar year for such service is less than $1,000 with respect to service performed during any calendar year commencing on or after January 1, 1995, ending on or before December 31, 1999, and the adjusted amount determined under section 218(c)(8)(B) of the Social Security Act for any calendar year commencing on or after January 1, 2000, with respect to service performed during such calendar year; or

(v) by an employee in a position compensated solely on a fee basis which is treated pursuant to section 1402(c)(2)(E) as a trade or business for purposes of inclusion of such fees in net earnings from self-employment;

for purposes of this subparagraph, except as provided in regulations prescribed by the Secretary, the term "retirement system" has the meaning

given such term by section 218(b)(4) of the Social Security Act;

(8)(A) service performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order, except that this subparagraph shall not apply to service performed by a member of such an order in the exercise of such duties, if an election of coverage under subsection (r) is in effect with respect to such order, or with respect to the autonomous subdivision thereof to which such member belongs;

(B) service performed in the employ of a church or qualified church-controlled organization if such church or organization has in effect an election under subsection (w), other than service in an unrelated trade or business (within the meaning of section 513(a));

(9) service performed by an individual as an employee or employee representative as defined in section 3231;

(10) service performed in the employ of—

(A) a school, college, or university, or

(B) an organization described in section 509(a)(3) if the organization is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of a school, college, or university and is operated, supervised, or controlled by or in

connection with such school, college, or university, unless it is a school, college, or university of a State or a political subdivision thereof and the services performed in its employ by a student referred to in section 218(c)(5) of the Social Security Act are covered under the agreement between the Commissioner of Social Security and such State entered into pursuant to section 218 of such Act;

if such service is performed by a student who is enrolled and regularly attending classes at such school, college, or university;

(11) service performed in the employ of a foreign government (including service as a consular or other officer or employee or a nondiplomatic representative);

(12) service performed in the employ of an instrumentality wholly owned by a foreign government—

(A) if the service is of a character similar to that performed in foreign countries by employees of the United States Government or of an instrumentality thereof; and

(B) if the Secretary of State shall certify to the Secretary of the Treasury that the foreign government, with respect to whose instrumentality and employees thereof exemption is claimed, grants an equivalent exemption with respect to similar service performed in the foreign country by employees of the United States Government and of instrumentalities thereof;

(13) service performed as a student nurse in the employ of a hospital or a nurses' training school by an individual who is enrolled and is regularly attending classes in a nurses' training school chartered or approved pursuant to State law;

(14)(A) service performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution;

(B) service performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such service, or is entitled to be credited with the unsold newspapers or magazines turned back;

(15) service performed in the employ of an international organization, except service which constitutes "employment" under subsection (y);

(16) service performed by an individual under an arrangement with the owner or tenant of land pursuant to which—

(A) such individual undertakes to produce agricultural or horticultural commodities (including

livestock, bees, poultry, and fur-bearing animals and wildlife) on such land,

(B) the agricultural or horticultural commodities produced by such individual, or the proceeds therefrom, are to be divided between such individual and such owner or tenant, and

(C) the amount of such individual's share depends on the amount of the agricultural or horticultural commodities produced;

(17) service in the employ of any organization which is performed (A) in any year during any part of which such organization is registered, or there is in effect a final order of the Subversive Activities Control Board requiring such organization to register, under the Internal Security Act of 1950, as amended, as a Communist-action organization, a Communist-front organization, or a Communist-infiltrated organization, and (B) after June 30, 1956;

(18) service performed in Guam by a resident of the Republic of the Philippines while in Guam on a temporary basis as a nonimmigrant alien admitted to Guam pursuant to section 101(a)(15)(H)(ii) of the Immigration and Nationality Act (8 U.S.C. 1101(a)(15)(H)(ii));

(19) Service which is performed by a nonresident alien individual for the period he is temporarily present in the United States as a nonimmigrant under subparagraph (F), (J), (M), or (Q) of section 101(a)(15) of the Immigration and Nationality Act, as

amended, and which is performed to carry out the purpose specified in subparagraph (F), (J), (M), or (Q), as the case may be;

(20) service (other than service described in paragraph (3)(A)) performed by an individual on a boat engaged in catching fish or other forms of aquatic animal life under an arrangement with the owner or operator of such boat pursuant to which—

(A) such individual does not receive any cash remuneration other than as provided in subparagraph (B) and other than cash remuneration—

(i) which does not exceed $100 per trip;

(ii) which is contingent on a minimum catch; and

(iii) which is paid solely for additional duties (such as mate, engineer, or cook) for which additional cash remuneration is traditional in the industry,

(B) such individual receives a share of the boat's (or the boats' in the case of a fishing operation involving more than one boat) catch of fish or other forms of aquatic animal life or a share of the proceeds from the sale of such catch, and

(C) the amount of such individual's share depends on the amount of the boat's (or the boats' in the case of a fishing operation involving more than one boat) catch of fish or other forms of aquatic animal life,

but only if the operating crew of such boat (or each boat from which the individual receives a share in the case of a fishing operation involving more than one boat) is normally made up of fewer than 10 individuals; or

(21) domestic service in a private home of the employer which—

(A) is performed in any year by an individual under the age of 18 during any portion of such year; and

(B) is not the principal occupation of such employee.

For purposes of paragraph (20), the operating crew of a boat shall be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals.

(c) Included and excluded service

For purposes of this chapter, if the services performed during one-half or more of any pay period by an employee for the person employing him constitute employment, all the services of such employee for such period shall be deemed to be employment; but if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment. As used in this sub-

section, the term "pay period" means a period (of not more than 31 consecutive days) for which a payment of remuneration is ordinarily made to the employee by the person employing him. This subsection shall not be applicable with respect to services performed in a pay period by an employee for the person employing him, where any of such service is excepted by subsection (b)(9).

(d) Employee

For purposes of this chapter, the term "employee" means—

(1) any officer of a corporation; or

(2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or

(3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person—

(A) as an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services, for his principal;

(B) as a full-time life insurance salesman;

(C) as a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or

goods furnished by such person which are required to be returned to such person or a person designated by him; or

(D) as a traveling or city salesman, other than as an agent-driver or commission-driver, engaged upon a full-time basis in the solicitation on behalf of, and the transmission to, his principal (except for side-line sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations;

if the contract of service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term "employee" under the provisions of this paragraph if such individual has a substantial investment in facilities used in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction not part of a continuing relationship with the person for whom the services are performed; or

(4) any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

(e) State, United States, and citizen

For purposes of this chapter—

(1) State

The term "State" includes the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa.

(2) United States

The term "United States" when used in a geographical sense includes the Commonwealth of Puerto Rico, the Virgin Islands, Guam, and American Samoa.

An individual who is a citizen of the Commonwealth of Puerto Rico (but not otherwise a citizen of the United States) shall be considered, for purposes of this section, as a citizen of the United States.

(f) American vessel and aircraft

For purposes of this chapter, the term "American vessel" means any vessel documented or numbered under the laws of the United States; and includes any vessel which is neither documented or numbered under the laws of the United States nor documented under the laws of any foreign country, if its crew is employed solely by one or more citizens or residents of the United States or corporations organized under the laws of the United States or of any State; and the term "American aircraft" means an aircraft registered under the laws of the United States.

(g) Agricultural labor

For purposes of this chapter, the term "agricultural labor" includes all service performed—

(1) on a farm, in the employ of any person, in connection with cultivating the soil, or in connection with raising or harvesting any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of livestock, bees, poultry, and fur-bearing animals and wildlife;

(2) in the employ of the owner or tenant or other operator of a farm, in connection with the operation, management, conservation, improvement, or maintenance of such farm and its tools and equipment, or in salvaging timber or clearing land of brush and other debris left by a hurricane, if the major part of such service is performed on a farm;

(3) in connection with the production or harvesting of any commodity defined as an agricultural commodity in section 15(g) of the Agricultural Marketing Act, as amended (12 U.S.C. 1141j), or in connection with the ginning of cotton, or in connection with the operation or maintenance of ditches, canals, reservoirs, or waterways, not owned or operated for profit, used exclusively for supplying and storing water for farming purposes;

(4)(A) in the employ of the operator of a farm in handling, planting, drying, packing, packaging, processing, freezing, grading, storing, or delivering to

storage or to market or to a carrier for transportation to market, in its unmanufactured state, any agricultural or horticultural commodity; but only if such operator produced more than one-half of the commodity with respect to which such service is performed;

(B) in the employ of a group of operators of farms (other than a cooperative organization) in the performance of service described in subparagraph (A), but only if such operators produced all of the commodity with respect to which such service is performed. For purposes of this subparagraph, any unincorporated group of operators shall be deemed a cooperative organization if the number of operators comprising such group is more than 20 at any time during the calendar year in which such service is performed;

(C) the provisions of subparagraphs (A) and (B) shall not be deemed to be applicable with respect to service performed in connection with commercial canning or commercial freezing or in connection with any agricultural or horticultural commodity after its delivery to a terminal market for distribution for consumption; or

(5) on a farm operated for profit if such service is not in the course of the employer's trade or business.

As used in this subsection, the term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily

for the raising of agricultural or horticultural commodities, and orchards.

(h) American employer

For purposes of this chapter, the term "American employer" means an employer which is—

(1) the United States or any instrumentality thereof,

(2) an individual who is a resident of the United States,

(3) a partnership, if two-thirds or more of the partners are residents of the United States,

(4) a trust, if all of the trustees are residents of the United States, or

(5) a corporation organized under the laws of the United States or of any State.

(i) Computation of wages in certain cases

(1) Domestic service

For purposes of this chapter, in the case of domestic service described in subsection (a)(7)(B), any payment of cash remuneration for such service which is more or less than a whole-dollar amount shall, under such conditions and to such extent as may be prescribed by regulations made under this chapter, be computed to the nearest dollar. For the purpose of the computation to the nearest dollar, the payment of a fractional part of a dollar shall be disregarded unless it amounts to one-half dollar or

more, in which case it shall be increased to $1. The amount of any payment of cash remuneration so computed to the nearest dollar shall, in lieu of the amount actually paid, be deemed to constitute the amount of cash remuneration for purposes of subsection (a)(7)(B).

(2) Service in the uniformed services

For purposes of this chapter, in the case of an individual performing service, as a member of a uniformed service, to which the provisions of subsection (m)(1) are applicable, the term "wages" shall, subject to the provisions of subsection (a)(1) of this section, include as such individual's remuneration for such service only (A) his basic pay as described in chapter 3 and section 1009 of title 37, United States Code, in the case of an individual performing service to which subparagraph (A) of such subsection (m)(1) applies, or (B) his compensation for such service as determined under section 206(a) of title 37, United States Code, in the case of an individual performing service to which subparagraph (B) of such subsection (m)(1) applies.

(3) Peace Corps volunteer service

For purposes of this chapter, in the case of an individual performing service, as a volunteer or volunteer leader within the meaning of the Peace Corps Act, to which the provisions of section 3121(p) are applicable, the term "wages" shall, subject to the provisions of subsection (a)(1) of this section, include as such individual's remuneration

for such service only amounts paid pursuant to section 5(c) or 6(1) of the Peace Corps Act.

(4) Service performed by certain members of religious orders

For purposes of this chapter, in any case where an individual is a member of a religious order (as defined in subsection (r)(2)) performing service in the exercise of duties required by such order, and an election of coverage under subsection (r) is in effect with respect to such order or with respect to the autonomous subdivision thereof to which such member belongs, the term "wages" shall, subject to the provisions of subsection (a)(1), include as such individual's remuneration for such service the fair market value of any board, lodging, clothing, and other perquisites furnished to such member by such order or subdivision thereof or by any other person or organization pursuant to an agreement with such order or subdivision, except that the amount included as such individual's remuneration under this paragraph shall not be less than $100 a month.

(5) Service performed by certain retired justices and judges

For purposes of this chapter, in the case of an individual performing service under the provisions of section 294 of title 28, United States Code (relating to assignment of retired justices and judges to active duty), the term "wages" shall not include any pay-

ment under section 371(b) of such title 28 which is received during the period of such service.

(j) Covered transportation service

For purposes of this chapter—

(1) Existing transportation systems—General rule

Except as provided in paragraph (2), all service performed in the employ of a State or political subdivision in connection with its operation of a public transportation system shall constitute covered transportation service if any part of the transportation system was acquired from private ownership after 1936 and prior to 1951.

(2) Existing transportation systems—Cases in which no transportation employees, or only certain employees, are covered

Service performed in the employ of a State or political subdivision in connection with the operation of its public transportation system shall not constitute covered transportation service if—

(A) any part of the transportation system was acquired from private ownership after 1936 and prior to 1951, and substantially all service in connection with the operation of the transportation system was, on December 31, 1950, covered under a general retirement system providing benefits which, by reason of a provision of the State constitution dealing specifically with retirement systems of the State or political subdivisions thereof, cannot be diminished or impaired; or

(B) no part of the transportation system operated by the State or political subdivision on December 31, 1950, was acquired from private ownership after 1936 and prior to 1951;

except that if such State or political subdivision makes an acquisition after 1950 from private ownership of any part of its transportation system, then, in the case of any employee who—

(C) became an employee of such State or political subdivision in connection with and at the time of its acquisition after 1950 of such part, and

(D) prior to such acquisition rendered service in employment (including as employment service covered by an agreement under section 218 of the Social Security Act) in connection with the operation of such part of the transportation system acquired by the State or political subdivision,

the service of such employee in connection with the operation of the transportation system shall constitute covered transportation service, commencing with the first day of the third calendar quarter following the calendar quarter in which the acquisition of such part took place, unless on such first day such service of such employee is covered by a general retirement system which does not, with respect to such employee, contain special provisions applicable only to employees described in subparagraph (C).

(3) Transportation systems acquired after 1950

All service performed in the employ of a State or political subdivision thereof in connection with its operation of a public transportation system shall constitute covered transportation service if the transportation system was not operated by the State or political subdivision prior to 1951 and, at the time of its first acquisition (after 1950) from private ownership of any part of its transportation system, the State or political subdivision did not have a general retirement system covering substantially all service performed in connection with the operation of the transportation system.

(4) Definitions

For purposes of this subsection—

(A) The term "general retirement system" means any pension, annuity, retirement, or similar fund or system established by a State or by a political subdivision thereof for employees of the State, political subdivision, or both; but such term shall not include such a fund or system which covers only service performed in positions connected with the operation of its public transportation system.

(B) A transportation system or a part thereof shall be considered to have been acquired by a State or political subdivision from private ownership if prior to the acquisition service performed by employees in connection with the operation of the system or part thereof acquired constituted employment under this chapter or subchapter A of

chapter 9 of the Internal Revenue Code of 1939 or was covered by an agreement made pursuant to section 218 of the Social Security Act and some of such employees became employees of the State or political subdivision in connection with and at the time of such acquisition.

(C) The term "political subdivision" includes an instrumentality of—

(i) a State,

(ii) one or more political subdivisions of a State, or

(iii) a State and one or more of its political subdivisions.

[(k) Repealed. Pub. L. 98–21, title I, §102(b)(2), Apr. 20, 1983, 97 Stat. 71]

(*l*) Agreements entered into by American employers with respect to foreign affiliates

(1) Agreement with respect to certain employees of foreign affiliate

The Secretary shall, at the American employer's request, enter into an agreement (in such manner and form as may be prescribed by the Secretary) with any American employer (as defined in subsection (h)) who desires to have the insurance system established by title II of the Social Security Act extended to service performed outside the United States in the employ of any 1 or more of such employer's foreign affiliates (as defined in paragraph (6)) by all employees who are citizens or residents of

the United States, except that the agreement shall not apply to any service performed by, or remuneration paid to, an employee if such service or remuneration would be excluded from the term "employment" or "wages", as defined in this section, had the service been performed in the United States. Such agreement may be amended at any time so as to be made applicable, in the same manner and under the same conditions, with respect to any other foreign affiliate of such American employer. Such agreement shall be applicable with respect to citizens or residents of the United States who, on or after the effective date of the agreement, are employees of and perform services outside the United States for any foreign affiliate specified in the agreement. Such agreement shall provide—

(A) that the American employer shall pay to the Secretary, at such time or times as the Secretary may by regulations prescribe, amounts equivalent to the sum of the taxes which would be imposed by sections 3101 and 3111 (including amounts equivalent to the interest, additions to the taxes, additional amounts, and penalties which would be applicable) with respect to the remuneration which would be wages if the services covered by the agreement constituted employment as defined in this section; and

(B) that the American employer will comply with such regulations relating to payments and reports as the Secretary may prescribe to carry out the purposes of this subsection.

(2) Effective period of agreement

An agreement entered into pursuant to paragraph (1) shall be in effect for the period beginning with the first day of the calendar quarter in which such agreement is entered into or the first day of the succeeding calendar quarter, as may be specified in the agreement; except that in case such agreement is amended to include the services performed for any other affiliate and such amendment is executed after the first month following the first calendar quarter for which the agreement is in effect, the agreement shall be in effect with respect to service performed for such other affiliate only after the calendar quarter in which such amendment is executed. Notwithstanding any other provision of this subsection, the period for which any such agreement is effective with respect to any foreign entity shall terminate at the end of any calendar quarter in which the foreign entity, at any time in such quarter, ceases to be a foreign affiliate as defined in paragraph (6).

(3) No termination of agreement

No agreement under this subsection may be terminated, either in its entirety or with respect to any foreign affiliate, on or after June 15, 1989.

(4) Deposits in trust funds

For purposes of section 201 of the Social Security Act, relating to appropriations to the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund, such remuneration—

(A) paid for services covered by an agreement entered into pursuant to paragraph (1) as would be wages if the services constituted employment, and

(B) as is reported to the Secretary pursuant to the provisions of such agreement or of the regulations issued under this subsection,

shall be considered wages subject to the taxes imposed by this chapter.

(5) Overpayments and underpayments

(A) If more or less than the correct amount due under an agreement entered into pursuant to this subsection is paid with respect to any payment of remuneration, proper adjustments with respect to the amounts due under such agreement shall be made, without interest, in such manner and at such times as may be required by regulations prescribed by the Secretary.

(B) If an overpayment cannot be adjusted under subparagraph (A), the amount thereof shall be paid by the Secretary, through the Fiscal Service of the Treasury Department, but only if a claim for such overpayment is filed with the Secretary within two years from the time such overpayment was made.

(6) Foreign affiliate defined

For purposes of this subsection and section 210(a) of the Social Security Act—

(A) In general

A foreign affiliate of an American employer is any foreign entity in which such American employer has not less than a 10-percent interest.

(B) Determination of 10-percent interest

For purposes of subparagraph (A), an American employer has a 10-percent interest in any entity if such employer has such an interest directly (or through one or more entities)—

(i) in the case of a corporation, in the voting stock thereof, and

(ii) in the case of any other entity, in the profits thereof.

(7) American employer as separate entity

Each American employer which enters into an agreement pursuant to paragraph (1) of this subsection shall, for purposes of this subsection and section 6413(c)(2)(C), relating to special refunds in the case of employees of certain foreign entities, be considered an employer in its capacity as a party to such agreement separate and distinct from its identity as a person employing individuals on its own account.

(8) Regulations

Regulations of the Secretary to carry out the purposes of this subsection shall be designed to make the requirements imposed on American employers with respect to services covered by an agreement

entered into pursuant to this subsection the same, so far as practicable, as those imposed upon employers pursuant to this title with respect to the taxes imposed by this chapter.

(m) Service in the uniformed services

For purposes of this chapter—

(1) Inclusion of service

The term "employment" shall, notwithstanding the provisions of subsection (b) of this section, include—

(A) service performed by an individual as a member of a uniformed service on active duty, but such term shall not include any such service which is performed while on leave without pay, and

(B) service performed by an individual as a member of a uniformed service on inactive duty training.

(2) Active duty

The term "active duty" means "active duty" as described in paragraph (21) of section 101 of title 38, United States Code, except that it shall also include "active duty for training" as described in paragraph (22) of such section.

(3) Inactive duty training

The term "inactive duty training" means "inactive duty training" as described in paragraph (23) of such section 101.

(n) Member of a uniformed service

For purposes of this chapter, the term "member of a uniformed service" means any person appointed, enlisted, or inducted in a component of the Army, Navy, Air Force, Marine Corps, or Coast Guard (including a reserve component as defined in section 101(27) of title 38, United States Code), or in one of those services without specification of component, or as a commissioned officer of the Coast and Geodetic Survey, the National Oceanic and Atmospheric Administration Corps, or the Regular or Reserve Corps of the Public Health Service, and any person serving in the Army or Air Force under call or conscription. The term includes—

(1) a retired member of any of those services;

(2) a member of the Fleet Reserve or Fleet Marine Corps Reserve;

(3) a cadet at the United States Military Academy, a midshipman at the United States Naval Academy, and a cadet at the United States Coast Guard Academy or United States Air Force Academy;

(4) a member of the Reserve Officers' Training Corps, the Naval Reserve Officers' Training Corps, or the Air Force Reserve Officers' Training Corps, when ordered to annual training duty for fourteen days or more, and while performing authorized travel to and from that duty; and

(5) any person while en route to or from, or at, a place for final acceptance or for entry upon active duty in the military, naval, or air service—

(A) who has been provisionally accepted for such duty; or

(B) who, under the Military Selective Service Act, has been selected for active military, naval, or air service;

and has been ordered or directed to proceed to such place.

The term does not include a temporary member of the Coast Guard Reserve.

(*o*) Crew leader

For purposes of this chapter, the term "crew leader" means an individual who furnishes individuals to perform agricultural labor for another person, if such individual pays (either on his own behalf or on behalf of such person) the individuals so furnished by him for the agricultural labor performed by them and if such individual has not entered into a written agreement with such person whereby such individual has been designated as an employee of such person; and such individuals furnished by the crew leader to perform agricultural labor for another person shall be deemed to be the employees of such crew leader. For purposes of this chapter and chapter 2, a crew leader shall, with respect to service performed in furnishing individuals to perform agricultural labor for another person and service performed as a member of the

crew, be deemed not to be an employee of such other person.

(p) Peace Corps volunteer service

For purposes of this chapter, the term "employment" shall, notwithstanding the provisions of subsection (b) of this section, include service performed by an individual as a volunteer or volunteer leader within the meaning of the Peace Corps Act.

(q) Tips included for both employee and employer taxes

For purposes of this chapter, tips received by an employee in the course of his employment shall be considered remuneration for such employment (and deemed to have been paid by the employer for purposes of subsections (a) and (b) of section 3111). Such remuneration shall be deemed to be paid at the time a written statement including such tips is furnished to the employer pursuant to section 6053(a) or (if no statement including such tips is so furnished) at the time received; except that, in determining the employer's liability in connection with the taxes imposed by section 3111 with respect to such tips in any case where no statement including such tips was so furnished (or to the extent that the statement so furnished was inaccurate or incomplete), such remuneration shall be deemed for purposes of subtitle F to be paid on the date on which notice and demand for such taxes is made to the employer by the Secretary.

(r) Election of coverage by religious orders

(1) Certificate of election by order

A religious order whose members are required to take a vow of poverty, or any autonomous subdivision of such order, may file a certificate (in such form and manner, and with such official, as may be prescribed by regulations under this chapter) electing to have the insurance system established by title II of the Social Security Act extended to services performed by its members in the exercise of duties required by such order or such subdivision thereof. Such certificate of election shall provide that—

(A) such election of coverage by such order or subdivision shall be irrevocable;

(B) such election shall apply to all current and future members of such order, or in the case of a subdivision thereof to all current and future members of such order who belong to such subdivision;

(C) all services performed by a member of such an order or subdivision in the exercise of duties required by such order or subdivision shall be deemed to have been performed by such member as an employee of such order or subdivision; and

(D) the wages of each member, upon which such order or subdivision shall pay the taxes imposed by sections 3101 and 3111, will be determined as provided in subsection (i)(4).

(2) Definition of member

For purposes of this subsection, a member of a religious order means any individual who is subject to a vow of poverty as a member of such order and who performs tasks usually required (and to the extent usually required) of an active member of such order and who is not considered retired because of old age or total disability.

(3) Effective date for election

(A) A certificate of election of coverage shall be in effect, for purposes of subsection (b)(8) and for purposes of section 210(a)(8) of the Social Security Act, for the period beginning with whichever of the following may be designated by the order or subdivision thereof:

(i) the first day of the calendar quarter in which the certificate is filed,

(ii) the first day of the calendar quarter succeeding such quarter, or

(iii) the first day of any calendar quarter preceding the calendar quarter in which the certificate is filed, except that such date may not be earlier than the first day of the twentieth calendar quarter preceding the quarter in which such certificate is filed.

Whenever a date is designated under clause (iii), the election shall apply to services performed before the quarter in which the certificate is filed only if the member performing such services was a

member at the time such services were performed and is living on the first day of the quarter in which such certificate is filed.

(B) If a certificate of election filed pursuant to this subsection is effective for one or more calendar quarters prior to the quarter in which such certificate is filed, then—

(i) for purposes of computing interest and for purposes of section 6651 (relating to addition to tax for failure to file tax return), the due date for the return and payment of the tax for such prior calendar quarters resulting from the filing of such certificate shall be the last day of the calendar month following the calendar quarter in which the certificate is filed; and

(ii) the statutory period for the assessment of such tax shall not expire before the expiration of 3 years from such due date.

[(4) Repealed. Pub. L. 98–21, title I, §102(b)(3)(B), Apr. 20, 1983, 97 Stat. 71]

(s) Concurrent employment by two or more employers

For purposes of sections 3102, 3111, and 3121(a)(1), if two or more related corporations concurrently employ the same individual and compensate such individual through a common paymaster which is one of such corporations, each such corporation shall be considered to have paid as remuneration to such individual only the amounts actually disbursed by it to such individual and shall not be considered to have paid as

remuneration to such individual amounts actually disbursed to such individual by another of such corporations.

[(t) Repealed. Pub. L. 100–203, title IX, §9006(b)(2), Dec. 22, 1987, 101 Stat. 1330–289]

(u) Application of hospital insurance tax to Federal, State, and local employment

(1) Federal employment

For purposes of the taxes imposed by sections 3101(b) and 3111(b), subsection (b) shall be applied without regard to paragraph (5) thereof.

(2) State and local employment

For purposes of the taxes imposed by sections 3101(b) and 3111(b)—

(A) In general

Except as provided in subparagraphs (B) and (C), subsection (b) shall be applied without regard to paragraph (7) thereof.

(B) Exception for certain services

Service shall not be treated as employment by reason of subparagraph (A) if—

(i) the service is included under an agreement under section 218 of the Social Security Act, or

(ii) the service is performed—

(I) by an individual who is employed by a State or political subdivision thereof to relieve him from unemployment,

(II) in a hospital, home, or other institution by a patient or inmate thereof as an employee of a State or political subdivision thereof or of the District of Columbia,

(III) by an individual, as an employee of a State or political subdivision thereof or of the District of Columbia, serving on a temporary basis in case of fire, storm, snow, earthquake, flood or other similar emergency,

(IV) by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of hospitals of the District of Columbia Government), other than as a medical or dental intern or a medical or dental resident in training,

(V) by an election official or election worker if the remuneration paid in a calendar year for such service is less than $1,000 with respect to service performed during any calendar year commencing on or after January 1, 1995, ending on or before December 31, 1999, and the adjusted amount determined under section 218(c)(8)(B) of the Social Security Act for any calendar year commencing on or after January 1, 2000, with respect to service performed during such calendar year, or

(VI) by an individual in a position described in section 1402(c)(2)(E).

As used in this subparagraph, the terms "State" and "political subdivision" have the meanings given those terms in section 218(b) of the Social Security Act.

(C) Exception for current employment which continues

Service performed for an employer shall not be treated as employment by reason of subparagraph (A) if—

(i) such service would be excluded from the term "employment" for purposes of this chapter if subparagraph (A) did not apply;

(ii) such service is performed by an individual—

(I) who was performing substantial and regular service for remuneration for that employer before April 1, 1986,

(II) who is a bona fide employee of that employer on March 31, 1986, and

(III) whose employment relationship with that employer was not entered into for purposes of meeting the requirements of this subparagraph; and

(iii) the employment relationship with that employer has not been terminated after March 31, 1986.

(D) Treatment of agencies and instrumentalities

For purposes of subparagraph (C), under regulations—

(i) All agencies and instrumentalities of a State (as defined in section 218(b) of the Social Security Act) or of the District of Columbia shall be treated as a single employer.

(ii) All agencies and instrumentalities of a political subdivision of a State (as so defined) shall be treated as a single employer and shall not be treated as described in clause (i).

(3) Medicare qualified government employment

For purposes of this chapter, the term "medicare qualified government employment" means service which—

(A) is employment (as defined in subsection (b)) with the application of paragraphs (1) and (2), but

(B) would not be employment (as so defined) without the application of such paragraphs.

(v) Treatment of certain deferred compensation and salary reduction arrangements

(1) Certain employer contributions treated as wages

Nothing in any paragraph of subsection (a) (other than paragraph (1)) shall exclude from the term "wages"—

(A) any employer contribution under a qualified cash or deferred arrangement (as defined in section

401(k)) to the extent not included in gross income by reason of section 402(e)(3) or consisting of designated Roth contributions (as defined in section 402A(c)), or

(B) any amount treated as an employer contribution under section 414(h)(2) where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).

(2) Treatment of certain nonqualified deferred compensation plans

(A) In general

Any amount deferred under a nonqualified deferred compensation plan shall be taken into account for purposes of this chapter as of the later of—

(i) when the services are performed, or

(ii) when there is no substantial risk of forfeiture of the rights to such amount.

The preceding sentence shall not apply to any excess parachute payment (as defined in section 280G(b)) or to any specified stock compensation (as defined in section 4985) on which tax is imposed by section 4985.

(B) Taxed only once

Any amount taken into account as wages by reason of subparagraph (A) (and the income attributa-

ble thereto) shall not thereafter be treated as wages for purposes of this chapter.

(C) Nonqualified deferred compensation plan

For purposes of this paragraph, the term "nonqualified deferred compensation plan" means any plan or other arrangement for deferral of compensation other than a plan described in subsection (a)(5).

(3) Exempt governmental deferred compensation plan

For purposes of subsection (a)(5), the term "exempt governmental deferred compensation plan" means any plan providing for deferral of compensation established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing. Such term shall not include—

(A) any plan to which section 83, 402(b), 403(c), 457(a), or 457(f)(1) applies,

(B) any annuity contract described in section 403(b), and

(C) the Thrift Savings Fund (within the meaning of subchapter III of chapter 84 of title 5, United States Code).

(w) Exemption of churches and qualified church-controlled organizations

(1) General rule

Any church or qualified church-controlled organization (as defined in paragraph (3)) may make an election within the time period described in paragraph (2), in accordance with such procedures as the Secretary determines to be appropriate, that services performed in the employ of such church or organization shall be excluded from employment for purposes of title II of the Social Security Act and this chapter. An election may be made under this subsection only if the church or qualified church-controlled organization states that such church or organization is opposed for religious reasons to the payment of the tax imposed under section 3111.

(2) Timing and duration of election

An election under this subsection must be made prior to the first date, more than 90 days after July 18, 1984, on which a quarterly employment tax return for the tax imposed under section 3111 is due, or would be due but for the election, from such church or organization. An election under this subsection shall apply to current and future employees, and shall apply to service performed after December 31, 1983. The election may be revoked by the church or organization under regulations prescribed by the Secretary. The election shall be revoked by the Secretary if such church or organization fails to furnish the information required under section 6051 to

the Secretary for a period of 2 years or more with respect to remuneration paid for such services by such church or organization, and, upon request by the Secretary, fails to furnish all such previously unfurnished information for the period covered by the election. Any revocation under the preceding sentence shall apply retroactively to the beginning of the 2-year period for which the information was not furnished.

(3) Definitions

(A) For purposes of this subsection, the term "church" means a church, a convention or association of churches, or an elementary or secondary school which is controlled, operated, or principally supported by a church or by a convention or association of churches.

(B) For purposes of this subsection, the term "qualified church-controlled organization" means any church-controlled tax-exempt organization described in section 501(c)(3), other than an organization which—

(i) offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services, or facilities; and

(ii) normally receives more than 25 percent of its support from either (I) governmental sources, or (II) receipts from admissions, sales of merchandise,

performance of services, or furnishing of facilities, in activities which are not unrelated trades or businesses, or both.

(x) Applicable dollar threshold

For purposes of subsection (a)(7)(B), the term "applicable dollar threshold" means $1,000. In the case of calendar years after 1995, the Commissioner of Social Security shall adjust such $1,000 amount at the same time and in the same manner as under section 215(a)(1)(B)(ii) of the Social Security Act with respect to the amounts referred to in section 215(a)(1)(B)(i) of such Act, except that, for purposes of this paragraph, 1993 shall be substituted for the calendar year referred to in section 215(a)(1)(B)(ii)(II) of such Act. If any amount as adjusted under the preceding sentence is not a multiple of $100, such amount shall be rounded to the next lowest multiple of $100.

(y) Service in the employ of international organizations by certain transferred Federal employees

(1) In general

For purposes of this chapter, service performed in the employ of an international organization by an individual pursuant to a transfer of such individual to such international organization pursuant to section 3582 of title 5, United States Code, shall constitute "employment" if—

(A) immediately before such transfer, such individual performed service with a Federal agency which constituted "employment" under subsection

(b) for purposes of the taxes imposed by sections 3101(a) and 3111(a), and

(B) such individual would be entitled, upon separation from such international organization and proper application, to reemployment with such Federal agency under such section 3582.

(2) Definitions

For purposes of this subsection—

(A) Federal agency

The term "Federal agency" means an agency, as defined in section 3581(1) of title 5, United States Code.

(B) International organization

The term "international organization" has the meaning provided such term by section 3581(3) of title 5, United States Code.

(z) Treatment of certain foreign persons as American employers

(1) In general

If any employee of a foreign person is performing services in connection with a contract between the United States Government (or any instrumentality thereof) and any member of any domestically controlled group of entities which includes such foreign person, such foreign person shall be treated for purposes of this chapter as an American employer with respect to such services performed by such employee.

(2) Domestically controlled group of entities

For purposes of this subsection—

(A) In general

The term "domestically controlled group of entities" means a controlled group of entities the common parent of which is a domestic corporation.

(B) Controlled group of entities

The term "controlled group of entities" means a controlled group of corporations as defined in section 1563(a)(1), except that—

(i) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein, and

(ii) the determination shall be made without regard to subsections (a)(4) and (b)(2) of section 1563.

A partnership or any other entity (other than a corporation) shall be treated as a member of a controlled group of entities if such entity is controlled (within the meaning of section 954(d)(3)) by members of such group (including any entity treated as a member of such group by reason of this sentence).

(3) Liability of common parent

In the case of a foreign person who is a member of any domestically controlled group of entities, the common parent of such group shall be jointly and

severally liable for any tax under this chapter for which such foreign person is liable by reason of this subsection, and for any penalty imposed on such person by this title with respect to any failure to pay such tax or to file any return or statement with respect to such tax or wages subject to such tax. No deduction shall be allowed under this title for any liability imposed by the preceding sentence.

(4) Provisions preventing double taxation

(A) Agreements

Paragraph (1) shall not apply to any services which are covered by an agreement under subsection (*l*).

(B) Equivalent foreign taxation

Paragraph (1) shall not apply to any services if the employer establishes to the satisfaction of the Secretary that the remuneration paid by such employer for such services is subject to a tax imposed by a foreign country which is substantially equivalent to the taxes imposed by this chapter.

(5) Cross reference

For relief from taxes in cases covered by certain international agreements, see sections 3101(c) and 3111(c).

3. 26 U.S.C. 3401 (2006 & Supp. V 2011) provides:

Definitions

(a) Wages

For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include remuneration paid—

(1) for active service performed in a month for which such employee is entitled to the benefits of section 112 (relating to certain combat zone compensation of members of the Armed Forces of the United States) to the extent remuneration for such service is excludable from gross income under such section; or

(2) for agricultural labor (as defined in section 3121(g)) unless the remuneration paid for such labor is wages (as defined in section 3121(a)); or

(3) for domestic service in a private home, local college club, or local chapter of a college fraternity or sorority; or

(4) for service not in the course of the employer's trade or business performed in any calendar quarter by an employee, unless the cash remuneration paid for such service is $50 or more and such service is performed by an individual who is regularly employed by such employer to perform such service. For purposes of this paragraph, an individual shall

be deemed to be regularly employed by an employer during a calendar quarter only if—

(A) on each of some 24 days during such quarter such individual performs for such employer for some portion of the day service not in the course of the employer's trade or business; or

(B) such individual was regularly employed (as determined under subparagraph (A)) by such employer in the performance of such service during the preceding calendar quarter; or

(5) for services by a citizen or resident of the United States for a foreign government or an international organization; or

(6) for such services, performed by a nonresident alien individual, as may be designated by regulations prescribed by the Secretary; or

[(7) Repealed. Pub. L. 89-809, title I, §103(k), Nov. 13, 1966, 80 Stat. 1554]

(8)(A) for services for an employer (other than the United States or any agency thereof)—

(i) performed by a citizen of the United States if, at the time of the payment of such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under section 911; or

(ii) performed in a foreign country or in a possession of the United States by such a citizen if, at the time of the payment of such remuneration, the

employer is required by the law of any foreign country or possession of the United States to withhold income tax upon such remuneration; or

(B) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within a possession of the United States (other than Puerto Rico), if it is reasonable to believe that at least 80 percent of the remuneration to be paid to the employee by such employer during the calendar year will be for such services; or

(C) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within Puerto Rico, if it is reasonable to believe that during the entire calendar year the employee will be a bona fide resident of Puerto Rico; or

(D) for services for the United States (or any agency thereof) performed by a citizen of the United States within a possession of the United States to the extent the United States (or such agency) withholds taxes on such remuneration pursuant to an agreement with such possession; or

(9) for services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(10)(A) for services performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution; or

(B) for services performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such services, or is entitled to be credited with the unsold newspapers or magazines turned back; or

(11) for services not in the course of the employer's trade or business, to the extent paid in any medium other than cash; or

(12) to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust; or

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a); or

(C) for a payment described in section 402(h)(1) and (2) if, at the time of such payment, it is reasonable to believe that the employee will be entitled to an exclusion under such section for payment; or

(D) under an arrangement to which section 408(p) applies; or

(E) under or to an eligible deferred compensation plan which, at the time of such payment, is a plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A),[1] or

(13) pursuant to any provision of law other than section 5(c) or 6(1) of the Peace Corps Act, for service performed as a volunteer or volunteer leader within the meaning of such Act; or

(14) in the form of group-term life insurance on the life of an employee; or

(15) to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under section 217 (determined without regard to section 274(n)); or

(16)(A) as tips in any medium other than cash;

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[1] So in original. The comma probably should be a semicolon.

(B) as cash tips to an employee in any calendar month in the course of his employment by an employer unless the amount of such cash tips is $20 or more;[2]

(17) for service described in section 3121(b)(20);[2]

(18) for any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127, 129, 134(b)(4), or 134(b)(5);[2]

(19) for any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 108(f)(4), 117, or 132;[2]

(20) for any medical care reimbursement made to or for the benefit of an employee under a self-insured medical reimbursement plan (within the meaning of section 105(h)(6));[2]

(21) for any payment made to or for the benefit of an employee if at the time of such payment it is reasonable to believe that the employee will be able to exclude such payment from income under section 106(b);[2]

(22) any payment made to or for the benefit of an employee if at the time of such payment it is reason-

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[2] So in original. Probably should be followed by "or".

able to believe that the employee will be able to exclude such payment from income under section 106(d); or

(23) for any benefit or payment which is excludable from the gross income of the employee under section 139B(b).

The term "wages" includes any amount includible in gross income of an employee under section 409A and payment of such amount shall be treated as having been made in the taxable year in which the amount is so includible.

(b) Payroll period

For purposes of this chapter, the term "payroll period" means a period for which a payment of wages is ordinarily made to the employee by his employer, and the term "miscellaneous payroll period" means a payroll period other than a daily, weekly, biweekly, semimonthly, monthly, quarterly, semiannual or annual payroll period.

(c) Employee

For purposes of this chapter, the term "employee" includes an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term "employee" also includes an officer of a corporation.

(d) Employer

For purposes of this chapter, the term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that—

(1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for purposes of subsection (a)) means the person having control of the payment of such wages, and

(2) in the case of a person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, the term "employer" (except for purposes of subsection (a)) means such person.

(e) Number of withholding exemptions claimed

For purposes of this chapter, the term "number of withholding exemptions claimed" means the number of withholding exemptions claimed in a withholding exemption certificate in effect under section 3402(f), or in effect under the corresponding section of prior law, except that if no such certificate is in effect, the number of withholding exemptions claimed shall be considered to be zero.

(f) Tips

For purposes of subsection (a), the term "wages" includes tips received by an employee in the course of his

employment. Such wages shall be deemed to be paid at the time a written statement including such tips is furnished to the employer pursuant to section 6053(a) or (if no statement including such tips is so furnished) at the time received.

(g) Crew leader rules to apply

Rules similar to the rules of section 3121(*o*) shall apply for purposes of this chapter.

(h) Differential wage payments to active duty members of the uniformed services

(1) In general

For purposes of subsection (a), any differential wage payment shall be treated as a payment of wages by the employer to the employee.

(2) Differential wage payment

For purposes of paragraph (1), the term "differential wage payment" means any payment which—

(A) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services (as defined in chapter 43 of title 38, United States Code) while on active duty for a period of more than 30 days, and

(B) represents all or a portion of the wages the individual would have received from the employer if the individual were performing service for the employer.

4. 26 U.S.C. 3402 (2006 & Supp. V 2011) provides:

Income tax collected at source

(a) Requirement of withholding

(1) In general

Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Any tables or procedures prescribed under this paragraph shall—

(A) apply with respect to the amount of wages paid during such periods as the Secretary may prescribe, and

(B) be in such form, and provide for such amounts to be deducted and withheld, as the Secretary determines to be most appropriate to carry out the purposes of this chapter and to reflect the provisions of chapter 1 applicable to such periods.

(2) Amount of wages

For purposes of applying tables or procedures prescribed under paragraph (1), the term "the amount of wages" means the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption. The amount of each withholding exemption shall be equal to the amount of one per-

sonal exemption provided in section 151(b), prorated to the payroll period. The maximum number of withholding exemptions permitted shall be calculated in accordance with regulations prescribed by the Secretary under this section, taking into account any reduction in withholding to which an employee is entitled under this section.

(b) Percentage method of withholding

(1) If wages are paid with respect to a period which is not a payroll period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(2) In any case in which wages are paid by an employer without regard to any payroll period or other period, the withholding exemption allowable with respect to each payment of such wages shall be the exemption allowed for a miscellaneous payroll period containing a number of days equal to the number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(3) In any case in which the period, or the time described in paragraph (2), in respect of any wages is less than one week, the Secretary, under regulations

prescribed by him, may authorize an employer to compute the tax to be deducted and withheld as if the aggregate of the wages paid to the employee during the calendar week were paid for a weekly payroll period.

(4) In determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(c) Wage bracket withholding

(1) At the election of the employer with respect to any employee, the employer shall deduct and withhold upon the wages paid to such employee a tax (in lieu of the tax required to be deducted and withheld under subsection (a)) determined in accordance with tables prescribed by the Secretary in accordance with paragraph (6).

(2) If wages are paid with respect to a period which is not a payroll period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days (including Sundays and holidays) equal to the number of days in the period with respect to which such wages are paid.

(3) In any case in which wages are paid by an employer without regard to any payroll period or other period, the amount to be deducted and withheld shall be that applicable in the case of a miscellaneous payroll period containing a number of days equal to the

number of days (including Sundays and holidays) which have elapsed since the date of the last payment of such wages by such employer during the calendar year, or the date of commencement of employment with such employer during such year, or January 1 of such year, whichever is the later.

(4) In any case in which the period, or the time described in paragraph (3), in respect of any wages is less than one week, the Secretary, under regulations prescribed by him, may authorize an employer to determine the amount to be deducted and withheld under the tables applicable in the case of a weekly payroll period, in which case the aggregate of the wages paid to the employee during the calendar week shall be considered the weekly wages.

(5) If the wages exceed the highest wage bracket, in determining the amount to be deducted and withheld under this subsection, the wages may, at the election of the employer, be computed to the nearest dollar.

(6) In the case of wages paid after December 31, 1969, the amount deducted and withheld under paragraph (1) shall be determined in accordance with tables prescribed by the Secretary. In the tables so prescribed, the amounts set forth as amounts of wages and amounts of income tax to be deducted and withheld shall be computed on the basis of the table for an annual payroll period prescribed pursuant to subsection (a).

(d) Tax paid by recipient

If the employer, in violation of the provisions of this chapter, fails to deduct and withhold the tax under this chapter, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall not be collected from the employer; but this subsection shall in no case relieve the employer from liability for any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold.

(e) Included and excluded wages

If the remuneration paid by an employer to an employee for services performed during one-half or more of any payroll period of not more than 31 consecutive days constitutes wages, all the remuneration paid by such employer to such employee for such period shall be deemed to be wages; but if the remuneration paid by an employer to an employee for services performed during more than one-half of any such payroll period does not constitute wages, then none of the remuneration paid by such employer to such employee for such period shall be deemed to be wages.

(f) Withholding exemptions

(1) In general

An employee receiving wages shall on any day be entitled to the following withholding exemptions:

(A) an exemption for himself unless he is an individual described in section 151(d)(2);

(B) if the employee is married, any exemption to which his spouse is entitled, or would be entitled if such spouse were an employee receiving wages, under subparagraph (A) or (D), but only if such spouse does not have in effect a withholding exemption certificate claiming such exemption;

(C) an exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(c) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit;

(D) any allowance to which he is entitled under subsection (m), but only if his spouse does not have in effect a withholding exemption certificate claiming such allowance; and

(E) a standard deduction allowance which shall be an amount equal to one exemption (or more than one exemption if so prescribed by the Secretary) unless (i) he is married (as determined under section 7703) and his spouse is an employee receiving wages subject to withholding or (ii) he has withholding exemption certificates in effect with respect to more than one employer.

For purposes of this title, any standard deduction allowance under subparagraph (E) shall be treated as if it were denominated a withholding exemption.

(2) Exemption certificates

(A) On commencement of employment

On or before the date of the commencement of employment with an employer, the employee shall furnish the employer with a signed withholding exemption certificate relating to the number of withholding exemptions which he claims, which shall in no event exceed the number to which he is entitled.

(B) Change of status

If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is less than the number of withholding exemptions claimed by the employee on the withholding exemption certificate then in effect with respect to him, the employee shall within 10 days thereafter furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day. If, on any day during the calendar year, the number of withholding exemptions to which the employee is entitled is greater than the number of withholding exemptions claimed, the employee may furnish the employer with a new withholding exemption certificate relating to the number of withholding exemptions which the employee then claims, which shall in no event exceed the number to which he is entitled on such day.

(C) Change of status which affects next calendar year

If on any day during the calendar year the number of withholding exemptions to which the employee will be, or may reasonably be expected to be, entitled at the beginning of his next taxable year under subtitle A is different from the number to which the employee is entitled on such day, the employee shall, in such cases and at such times as the Secretary may by regulations prescribe, furnish the employer with a withholding exemption certificate relating to the number of withholding exemptions which he claims with respect to such next taxable year, which shall in no event exceed the number to which he will be, or may reasonably be expected to be, so entitled.

(3) When certificate takes effect

(A) First certificate furnished

A withholding exemption certificate furnished the employer in cases in which no previous such certificate is in effect shall take effect as of the beginning of the first payroll period ending, or the first payment of wages made without regard to a payroll period, on or after the date on which such certificate is so furnished.

(B) Furnished to take place of existing certificate

(i) In general

Except as provided in clauses (ii) and (iii), a withholding exemption certificate furnished to the

employer in cases in which a previous such certificate is in effect shall take effect as of the beginning of the 1st payroll period ending (or the 1st payment of wages made without regard to a payroll period) on or after the 30th day after the day on which such certificate is so furnished.

(ii) Employer may elect earlier effective date

At the election of the employer, a certificate described in clause (i) may be made effective beginning with any payment of wages made on or after the day on which the certificate is so furnished and before the 30th day referred to in clause (i).

(iii) Change of status which affects next year

Any certificate furnished pursuant to paragraph (2)(C) shall not take effect, and may not be made effective, with respect to any payment of wages made in the calendar year in which the certificate is furnished.

(4) Period during which certificate remains in effect

A withholding exemption certificate which takes effect under this subsection, or which on December 31, 1954, was in effect under the corresponding subsection of prior law, shall continue in effect with respect to the employer until another such certificate takes effect under this subsection.

(5) Form and contents of certificate

Withholding exemption certificates shall be in such form and contain such information as the Secretary may by regulations prescribe.

(6) Exemption of certain nonresident aliens

Notwithstanding the provisions of paragraph (1), a nonresident alien individual (other than an individual described in section 3401(a)(6)(A) or (B)) shall be entitled to only one withholding exemption.

(7) Exemption where certificate with another employer is in effect

If a withholding exemption certificate is in effect with respect to one employer, an employee shall not be entitled under a certificate in effect with any other employer to any withholding exemption which he has claimed under such first certificate.

(g) Overlapping pay periods, and payment by agent or fiduciary

If a payment of wages is made to an employee by an employer—

(1) with respect to a payroll period or other period, any part of which is included in a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(2) without regard to any payroll period or other period, but on or prior to the expiration of a payroll period or other period with respect to which wages are also paid to such employee by such employer, or

(3) with respect to a period beginning in one and ending in another calendar year, or

(4) through an agent, fiduciary, or other person who also has the control, receipt, custody, or disposal of, or pays, the wages payable by another employer to such employee,

the manner of withholding and the amount to be deducted and withheld under this chapter shall be determined in accordance with regulations prescribed by the Secretary under which the withholding exemption allowed to the employee in any calendar year shall approximate the withholding exemption allowable with respect to an annual payroll period.

(h) Alternative methods of computing amount to be withheld

The Secretary may, under regulations prescribed by him, authorize—

(1) Withholding on basis of average wages

An employer—

(A) to estimate the wages which will be paid to any employee in any quarter of the calendar year,

(B) to determine the amount to be deducted and withheld upon each payment of wages to such employee during such quarter as if the appropriate average of the wages so estimated constituted the actual wages paid, and

(C) to deduct and withhold upon any payment of wages to such employee during such quarter (and,

in the case of tips referred to in subsection (k), within 30 days thereafter) such amount as may be necessary to adjust the amount actually deducted and withheld upon the wages of such employee during such quarter to the amount required to be deducted and withheld during such quarter without regard to this subsection.

(2) Withholding on basis of annualized wages

An employer to determine the amount of tax to be deducted and withheld upon a payment of wages to an employee for a payroll period by—

(A) multiplying the amount of an employee's wages for a payroll period by the number of such payroll periods in the calendar year,

(B) determining the amount of tax which would be required to be deducted and withheld upon the amount determined under subparagraph (A) if such amount constituted the actual wages for the calendar year and the payroll period of the employee were an annual payroll period, and

(C) dividing the amount of tax determined under subparagraph (B) by the number of payroll periods (described in subparagraph (A)) in the calendar year.

(3) Withholding on basis of cumulative wages

An employer, in the case of any employee who requests to have the amount of tax to be withheld from his wages computed on the basis of his cumulative wages, to—

(A) add the amount of the wages to be paid to the employee for the payroll period to the total amount of wages paid by the employer to the employee during the calendar year,

(B) divide the aggregate amount of wages computed under subparagraph (A) by the number of payroll periods to which such aggregate amount of wages relates,

(C) compute the total amount of tax that would have been required to be deducted and withheld under subsection (a) if the average amount of wages (as computed under subparagraph (B)) had been paid to the employee for the number of payroll periods to which the aggregate amount of wages (computed under subparagraph (A)) relates,

(D) determine the excess, if any, of the amount of tax computed under subparagraph (C) over the total amount of tax deducted and withheld by the employer from wages paid to the employee during the calendar year, and

(E) deduct and withhold upon the payment of wages (referred to in subparagraph (A)) to the employee an amount equal to the excess (if any) computed under subparagraph (D).

(4) Other methods

An employer to determine the amount of tax to be deducted and withheld upon the wages paid to an employee by any other method which will require

the employer to deduct and withhold upon such wages substantially the same amount as would be required to be deducted and withheld by applying subsection (a) or (c), either with respect to a payroll period or with respect to the entire taxable year.

(i) Changes in withholding

(1) In general

The Secretary may by regulations provide for increases in the amount of withholding otherwise required under this section in cases where the employee requests such changes.

(2) Treatment as tax

Any increased withholding under paragraph (1) shall for all purposes be considered tax required to be deducted and withheld under this chapter.

(j) Noncash remuneration to retail commission salesman

In the case of remuneration paid in any medium other than cash for services performed by an individual as a retail salesman for a person, where the service performed by such individual for such person is ordinarily performed for remuneration solely by way of cash commission an employer shall not be required to deduct or withhold any tax under this subchapter with respect to such remuneration, provided that such employer files with the Secretary such information with respect to such remuneration as the Secretary may by regulation prescribe.

(k) Tips

In the case of tips which constitute wages, subsection (a) shall be applicable only to such tips as are included in a written statement furnished to the employer pursuant to section 6053(a), and only to the extent that the tax can be deducted and withheld by the employer, at or after the time such statement is so furnished and before the close of the calendar year in which such statement is furnished, from such wages of the employee (excluding tips, but including funds turned over by the employee to the employer for the purpose of such deduction and withholding) as are under the control of the employer; and an employer who is furnished by an employee a written statement of tips (received in a calendar month) pursuant to section 6053(a) to which paragraph (16)(B) of section 3401(a) is applicable may deduct and withhold the tax with respect to such tips from any wages of the employee (excluding tips) under his control, even though at the time such statement is furnished the total amount of the tips included in statements furnished to the employer as having been received by the employee in such calendar month in the course of his employment by such employer is less than $20. Such tax shall not at any time be deducted and withheld in an amount which exceeds the aggregate of such wages and funds (including funds turned over under section 3102(c)(2) or section 3202(c)(2)) minus any tax required by section 3102(a) or section 3202(a) to be collected from such wages and funds.

(*l*) Determination and disclosure of marital status

(1) Determination of status by employer

For purposes of applying the tables in subsections (a) and (c) to a payment of wages, the employer shall treat the employee as a single person unless there is in effect with respect to such payment of wages a withholding exemption certificate furnished to the employer by the employee after the date of the enactment of this subsection indicating that the employee is married.

(2) Disclosure of status by employee

An employee shall be entitled to furnish the employer with a withholding exemption certificate indicating he is married only if, on the day of such furnishing, he is married (determined with the application of the rules in paragraph (3)). An employee whose marital status changes from married to single shall, at such time as the Secretary may by regulations prescribe, furnish the employer with a new withholding exemption certificate.

(3) Determination of marital status

For purposes of paragraph (2), an employee shall on any day be considered—

(A) as not married, if (i) he is legally separated from his spouse under a decree of divorce or separate maintenance, or (ii) either he or his spouse is, or on any preceding day within the calendar year was, a nonresident alien; or

(B) as married, if (i) his spouse (other than a spouse referred to in subparagraph (A)) died within the portion of his taxable year which precedes such day, or (ii) his spouse died during one of the two taxable years immediately preceding the current taxable year and, on the basis of facts existing at the beginning of such day, the employee reasonably expects, at the close of his taxable year, to be a surviving spouse (as defined in section 2(a)).

(m) Withholding allowances

Under regulations prescribed by the Secretary, an employee shall be entitled to additional withholding allowances or additional reductions in withholding under this subsection. In determining the number of additional withholding allowances or the amount of additional reductions in withholding under this subsection, the employee may take into account (to the extent and in the manner provided by such regulations)—

(1) estimated itemized deductions allowable under chapter 1 (other than the deductions referred to in section 151 and other than the deductions required to be taken into account in determining adjusted gross income under section 62(a) (other than paragraph (10) thereof)),

(2) estimated tax credits allowable under chapter 1, and

(3) such additional deductions (including the additional standard deduction under section 63(c)(3) for the aged and blind) and other items as may be specified by the Secretary in regulations.

(n) Employees incurring no income tax liability

Notwithstanding any other provision of this section, an employer shall not be required to deduct and withhold any tax under this chapter upon a payment of wages to an employee if there is in effect with respect to such payment a withholding exemption certificate (in such form and containing such other information as the Secretary may prescribe) furnished to the employer by the employee certifying that the employee—

(1) incurred no liability for income tax imposed under subtitle A for his preceding taxable year, and

(2) anticipates that he will incur no liability for income tax imposed under subtitle A for his current taxable year.

The Secretary shall by regulations provide for the coordination of the provisions of this subsection with the provisions of subsection (f).

(*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.

(B) Annuity

For purposes of this subsection, the term "annuity" means any amount paid to an individual as a pension or annuity.

(C) Sick pay

For purposes of this subsection, the term "sick pay" means any amount which—

(i) is paid to an employee pursuant to a plan to which the employer is a party, and

(ii) constitutes remuneration or a payment in lieu of remuneration for any period during which the employee is temporarily absent from work on account of sickness or personal injuries.

(3) Amount withheld from annuity payments or sick pay

If a payee makes a request that an annuity or any sick pay be subject to withholding under this chapter, the amount to be deducted and withheld under this chapter from any payment to which such request applies shall be an amount (not less than a minimum amount determined under regulations prescribed by the Secretary) specified by the payee in such request. The amount deducted and withheld with respect to a payment which is greater or less than a full payment shall bear the same relation to the specified amount as such payment bears to a full payment.

(4) Request for withholding

A request that an annuity or any sick pay be subject to withholding under this chapter—

(A) shall be made by the payee in writing to the person making the payments and shall contain the social security number of the payee,

(B) shall specify the amount to be deducted and withheld from each full payment, and

(C) shall take effect—

(i) in the case of sick pay, with respect to payments made more than 7 days after the date on which such request is furnished to the payor, or

(ii) in the case of an annuity, at such time (after the date on which such request is furnished to the payor) as the Secretary shall by regulations prescribe.

Such a request may be changed or terminated by furnishing to the person making the payments a written statement of change or termination which shall take effect in the same manner as provided in subparagraph (C). At the election of the payor, any such request (or statement of change or revocation) may take effect earlier than as provided in subparagraph (C).

(5) Special rule for sick pay paid pursuant to certain collective-bargaining agreements

In the case of any sick pay paid pursuant to a collective-bargaining agreement between employee representatives and one or more employers which contains a provision specifying that this paragraph is to apply to sick pay paid pursuant to such agreement and contains a provision for determining the amount to be deducted and withheld from each payment of such sick pay—

(A) the requirement of paragraph (1)(C) that a request for withholding be in effect shall not apply, and

(B) except as provided in subsection (n), the amounts to be deducted and withheld under this chapter shall be determined in accordance with such agreement.

The preceding sentence shall not apply with respect to sick pay paid pursuant to any agreement to any individual unless the social security number of such individual is furnished to the payor and the payor is furnished with such information as is necessary to determine whether the payment is pursuant to the agreement and to determine the amount to be deducted and withheld.

(6) Coordination with withholding on designated distributions under section 3405

This subsection shall not apply to any amount which is a designated distribution (within the meaning of section 3405(e)(1)).

(p) Voluntary withholding agreements

(1) Certain Federal payments

(A) In general

If, at the time a specified Federal payment is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter, such payment shall be treated as if it were a payment of wages by an employer to an employee.

(B) Amount withheld

The amount to be deducted and withheld under this chapter from any payment to which any request under subparagraph (A) applies shall be an amount equal to the percentage of such payment specified in such request. Such a request shall apply to any payment only if the percentage specified is 7 percent, any percentage applicable to any of the 3 lowest income brackets in the table under section 1(c), or such other percentage as is permitted under regulations prescribed by the Secretary.

(C) Specified Federal payments

For purposes of this paragraph, the term "specified Federal payment" means—

(i) any payment of a social security benefit (as defined in section 86(d)),

(ii) any payment referred to in the second sentence of section 451(d) which is treated as insurance proceeds,

(iii) any amount which is includible in gross income under section 77(a), and

(iv) any other payment made pursuant to Federal law which is specified by the Secretary for purposes of this paragraph.

(D) Requests for withholding

Rules similar to the rules that apply to annuities under subsection (*o*)(4) shall apply to requests under this paragraph and paragraph (2).

(2) Voluntary withholding on unemployment benefits

If, at the time a payment of unemployment compensation (as defined in section 85(b)) is made to any person, a request by such person is in effect that such payment be subject to withholding under this chapter, then for purposes of this chapter and so much of subtitle F as relates to this chapter, such payment shall be treated as if it were a payment of wages by an employer to an employee. The amount to be deducted and withheld under this chapter from any payment to which any request under this para-

graph applies shall be an amount equal to 10 percent of such payment.

(3) Authority for other voluntary withholding

The Secretary is authorized by regulations to provide for withholding—

(A) from remuneration for services performed by an employee for the employee's employer which (without regard to this paragraph) does not constitute wages, and

(B) from any other type of payment with respect to which the Secretary finds that withholding would be appropriate under the provisions of this chapter,

if the employer and employee, or the person making and the person receiving such other type of payment, agree to such withholding. Such agreement shall be in such form and manner as the Secretary may by regulations prescribe. For purposes of this chapter (and so much of subtitle F as relates to this chapter), remuneration or other payments with respect to which such agreement is made shall be treated as if they were wages paid by an employer to an employee to the extent that such remuneration is paid or other payments are made during the period for which the agreement is in effect.

(q) Extension of withholding to certain gambling winnings

(1) General rule

Every person, including the Government of the United States, a State, or a political subdivision thereof, or any instrumentalities of the foregoing, making any payment of winnings which are subject to withholding shall deduct and withhold from such payment a tax in an amount equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment.

(2) Exemption where tax otherwise withheld

In the case of any payment of winnings which are subject to withholding made to a nonresident alien individual or a foreign corporation, the tax imposed under paragraph (1) shall not apply to any such payment subject to tax under section 1441(a) (relating to withholding on nonresident aliens) or tax under section 1442(a) (relating to withholding on foreign corporations).

(3) Winnings which are subject to withholding

For purposes of this subsection, the term "winnings which are subject to withholding" means proceeds from a wager determined in accordance with the following:

(A) In general

Except as provided in subparagraphs (B) and (C), proceeds of more than $5,000 from a wagering

transaction, if the amount of such proceeds is at least 300 times as large as the amount wagered.

(B) State-conducted lotteries

Proceeds of more than $5,000 from a wager placed in a lottery conducted by an agency of a State acting under authority of State law, but only if such wager is placed with the State agency conducting such lottery, or with its authorized employees or agents.

(C) Sweepstakes, wagering pools, certain parimutul pools, jai alai, and lotteries

Proceeds of more than $5,000 from—

(i) a wager placed in a sweepstakes, wagering pool, or lottery (other than a wager described in subparagraph (B)), or

(ii) a wagering transaction in a parimutuel pool with respect to horse races, dog races, or jai alai if the amount of such proceeds is at least 300 times as large as the amount wagered.

(4) Rules for determining proceeds from a wager

For purposes of this subsection—

(A) proceeds from a wager shall be determined by reducing the amount received by the amount of the wager, and

(B) proceeds which are not money shall be taken into account at their fair market value.

(5) Exception for bingo, keno, and slot machines

The tax imposed under paragraph (1) shall not apply to winnings from a slot machine, keno, and bingo.

(6) Statement by recipient

Every person who is to receive a payment of winnings which are subject to withholding shall furnish the person making such payment a statement, made under the penalties of perjury, containing the name, address, and taxpayer identification number of the person receiving the payment and of each person entitled to any portion of such payment.

(7) Coordination with other sections

For purposes of sections 3403 and 3404 and for purposes of so much of subtitle F (except section 7205) as relates to this chapter, payments to any person of winnings which are subject to withholding shall be treated as if they were wages paid by an employer to an employee.

(r) Extension of withholding to certain taxable payments of Indian casino profits

(1) In general

Every person, including an Indian tribe, making a payment to a member of an Indian tribe from the net revenues of any class II or class III gaming activity conducted or licensed by such tribe shall deduct and withhold from such payment a tax in an amount equal to such payment's proportionate share of the annualized tax.

(2) Exception

The tax imposed by paragraph (1) shall not apply to any payment to the extent that the payment, when annualized, does not exceed an amount equal to the sum of—

(A) the basic standard deduction (as defined in section 63(c)) for an individual to whom section 63(c)(2)(C)[21] applies, and

(B) the exemption amount (as defined in section 151(d)).

(3) Annualized tax

For purposes of paragraph (1), the term "annualized tax" means, with respect to any payment, the amount of tax which would be imposed by section 1(c) (determined without regard to any rate of tax in excess of the fourth lowest rate of tax applicable under section 1(c)) on an amount of taxable income equal to the excess of—

(A) the annualized amount of such payment, over

(B) the amount determined under paragraph (2).

(4) Classes of gaming activities, etc.

For purposes of this subsection, terms used in paragraph (1) which are defined in section 4 of the Indian Gaming Regulatory Act (25 U.S.C. 2701 et seq.), as in effect on the date of the enactment of this

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[21] See References in Text note below.

subsection, shall have the respective meanings given such terms by such section.

(5) Annualization

Payments shall be placed on an annualized basis under regulations prescribed by the Secretary.

(6) Alternate withholding procedures

At the election of an Indian tribe, the tax imposed by this subsection on any payment made by such tribe shall be determined in accordance with such tables or computational procedures as may be specified in regulations prescribed by the Secretary (in lieu of in accordance with paragraphs (2) and (3)).

(7) Coordination with other sections

For purposes of this chapter and so much of subtitle F as relates to this chapter, payments to any person which are subject to withholding under this subsection shall be treated as if they were wages paid by an employer to an employee.

(s) Exemption from withholding for any vehicle fringe benefit

(1) Employer election not to withhold

The employer may elect not to deduct and withhold any tax under this chapter with respect to any vehicle fringe benefit provided to any employee if such employee is notified by the employer of such election (at such time and in such manner as the Secretary shall by regulations prescribe). The preceding sentence shall not apply to any vehicle fringe benefit

unless the amount of such benefit is included by the employer on a statement timely furnished under section 6051.

(2) Employer must furnish W-2

Any vehicle fringe benefit shall be treated as wages from which amounts are required to be deducted and withheld under this chapter for purposes of section 6051.

(3) Vehicle fringe benefit

For purposes of this subsection, the term "vehicle fringe benefit" means any fringe benefit—

(A) which constitutes wages (as defined in section 3401), and

(B) which consists of providing a highway motor vehicle for the use of the employee.

5. Section 31.3121(a)-1 of Title 26 of the Code of Federal Regulations provides:

Wages.

(a)(1) Whether remuneration paid after 1954 for employment performed after 1936 constitutes wages is determined under section 3121(a). This section and §§ 31.3121(a)(1)-1 to 31.3121(a)(15)-1, inclusive (relating to the statutory exclusions from wages), apply with respect only to remuneration paid after 1954 for employment performed after 1936. Whether remuneration paid after 1936 and before 1940 for employment performed after 1936 constitutes wages shall be de-

termined in accordance with the applicable provisions of law and of 26 CFR (1939) Part 401 (Regulations 91). Whether remuneration paid after 1939 and before 1951 for employment performed after 1936 constitutes wages shall be determined in accordance with the applicable provisions of law and of 26 CFR (1939) Part 402 (Regulations 106). Whether remuneration paid after 1950 and before 1955 for employment performed after 1936 constitutes wages shall be determined in accordance with the applicable provisions of law and of 26 CFR (1939) Part 408 (Regulations 128).

(2) The term *compensation* as used in section 3231(e) of the Internal Revenue Code has the same meaning as the term *wages* as used in this section, determined without regard to section 3121(b)(9), except as specifically limited by the Railroad Retirement Tax Act (chapter 22 of the Internal Revenue Code) or regulation. The Commissioner may provide any additional guidance that may be necessary or appropriate in applying the definitions of sections 3121(a) and 3231(e).

(b) The term "wages" means all remuneration for employment unless specifically excepted under section 3121(a) (see §§ 31.3121(a)(1)-1 to 31.3121(a)(15)-1, inclusive) or paragraph (j) of this section.

(c) The name by which the remuneration for employment is designated is immaterial. Thus, salaries, fees, bonuses, and commissions on sales or on insurance premiums, are wages if paid as compensation for employment.

(d) Generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration constitutes wages. Thus, it may be paid on the basis of piecework, or a percentage of profits; and it may be paid hourly, daily, weekly, monthly, or annually. See, however, § 31.3121(a)(8)-1 which relates to the treatment of cash remuneration computed on a time basis for agricultural labor.

(e) Generally the medium in which the remuneration is paid is also immaterial. It may be paid in cash or in something other than cash, as for example, goods, lodging, food, or clothing. Remuneration paid in items other than cash shall be computed on the basis of the fair value of such items at the time of payment. See, however, §§ 31.3121 (a)(7)-1, 31.3121(a)(8)-1, 31.3121(a)(10)-1, and 31.3121(a)(12)-1, relating to the treatment of remuneration paid in any medium other than cash for services not in the course of the employer's trade or business and for domestic service in a private home of the employer, for agricultural labor, for services performed by certain homeworkers, and as tips, respectively.

(f) Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. The term "facilities or

privileges", however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.

(g) Amounts of so-called "vacation allowances" paid to an employee constitute wages. Thus, the salary of an employee on vacation, paid notwithstanding his absence from work, constitutes wages.

(h) Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment. For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see § 31.3121(a)-3.

(i) Remuneration for employment, unless such remuneration is specifically excepted under section 3121(a) or paragraph (j) of this section, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

Example. A is employed by B during the month of January 1955 in employment and is entitled to receive remuneration of $100 for the services performed for B, the employer, during the month. A leaves the employ of B at the close of business on January 31, 1955. On February 15, 1955 (when A is no longer an employee of B), B pays A the remuneration of $100 which was earned for the services performed in January. The $100 is wages and the taxes are payable with respect thereto.

(j) In addition to the exclusions specified in §§ 31.3121(a)(1)-1 to 31.3121(a)(15)-1, inclusive, the following types of payments are excluded from wages:

(1) Remuneration for services which do not constitute employment under section 3121(b) and which are not deemed to be employment under section 3121(c) (see § 31.3121(c)-1).

(2) Remuneration for services which are deemed not to be employment under section 3121(c) (see § 31.3121(c)-1).

(3) Tips or gratuities paid, prior to January 1, 1966, directly to an employee by a customer of an employer, and not accounted for by the employee to the employer. For provisions relating to the treatment of tips received by an employee after December 31, 1965, as wages, see §§ 31.3121(a)(12) and 31.3121(q).

(k) *Split-dollar life insurance arrangements.* Except as otherwise provided under section 3121(v), see

§§ 1.61-22 and 1.7872-15 of this chapter for rules relating to the treatment of split-dollar life insurance arrangements.

6. Section 31.3121(a)(3)-1 of Title 26 of the Code of Federal Regulations provides:

Retirement payments.

The term "wages" does not include any payment made by an employer to an employee (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) on account of the employee's retirement. Thus, payments made to an employee on account of his retirement are excluded from wages under this exception even though not made under a plan or system.

7. Section 31.3121(a)(13)-1 of Title 26 of the Code of Federal Regulations provides:

Payments under certain employers' plans after retirement, disability, or death.

(a) *In general.* The term "wages" does not include the amount of any payment or series of payments made after January 2, 1968, by an employer to, or on behalf of, an employee or any of his dependents under a plan established by the employer which makes provisions for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a class or classes of his

employees and their dependents), which is paid or commences to be paid upon or within a reasonable time after the termination of an employee's employment relationship because of the employee's—

(1) Death,

(2) Retirement for disability, or

(3) Retirement after attaining an age specified in the plan established by the employer or in a pension plan of the employer at the age at which a person in the employee's circumstances is eligible for retirement.

A payment or series of payments made under the circumstances described in the preceding sentence is excluded from "wages" even if made pursuant to an incentive compensation plan which also provides for the making of other types of payments. However, any payment or series of payments which would have been paid if the employee's relationship had not been terminated is not excluded from "wages" under this section and section 3121(a)(13). For example, lump-sum payments for unused vacation time or a final paycheck received after retirement are payments which the employee would have received whether or not he retired and therefore are not excluded from "wages" under this section. Further, if any payment is made upon or after termination of employment for any reason other than those set out in subparagraphs (1), (2), and (3) of this paragraph such payment is not excludable from "wages" by this section. For example, if a pension plan provides for retirement upon disability,

completion of 30 years of service, or attainment of age 65, and if an employee who is not disabled retires at age 61 after 30 years of service, none of the retirement payments made to the employee under the pension plan (including any made after he is 65) is excludable from "wages" under this section. However, if the pension plan had conditioned retirement after 30 years of service upon attainment of age 60, all of the retirement payments would have been excludable.

(b) *Plan.* The plan or system established by an employer need not provide for payments because of termination of employment for all the reasons set out in paragraphs (a)(1), (2), and (3) of this section, but such plan or system may provide for payments because of termination for any one or more of such reasons. Payments because of termination of employment for any one or more of such reasons under a plan or system established by an employer solely for the dependents of his employees are not within this exclusion from wages.

(c) *Dependents.* Dependents of an employee include the employee's husband or wife, children, and any other members of the employee's immediate family.

(d) *Benefit payment.* It is immaterial for purposes of this exclusion whether the amount or possibility of benefit payments is paid on account of services rendered or taken into consideration in fixing the amount of an employee's remuneration or whether such payments are required, expressly or impliedly, by the contract of service.

(e) *Example.* The application of this section may be illustrated by the following example:

Example. A, an employee, receives a salary of $1,500 a month, payable on the 5th day of the month following the month for which the salary is earned. A's employer has established an incentive compensation plan for a class of his employees, including A, providing for the payment of deferred compensation on termination of employment, including termination upon an employee's death, retirement at age 65 (the retirement age specified in the plan), or retirement for disability. On March 1, 1973, A attains the age of 65 and retires. On March 5, 1973, A receives $5,500 from his employer of which $1,500 represents A's salary for services he performed in February 1973, and $4,000 represents incentive compensation paid under the employer's plan. The amount of $4,000 is excluded from "wages" under this section. The amount of $1,500 is not excluded from "wages" under this section.

8. Section 31.3121(a)(14)-1 of Title 26 of the Code of Federal Regulations provides:

Payments by employer to survivor or estate of former employee.

The term "wages" does not include any payment by an employer to a survivor or the estate of a former employee made after 1972 and after the calendar year in which such employee died.

9. Section 31.3121(a)(15)-1 of Title 26 of the Code of Federal Regulations provides:

Payments by employer to disabled former employee.

The term "wages" does not include any payment made after 1972 by an employer to an employee, if at the time such payment is made such employee is entitled to disability insurance benefits under section 223(a) of the Social Security Act and such entitlement commenced prior to the calendar year in which such payment is made, and if such employee did not perform any service for such employer during the period for which such payment is made.

10. Section 31.3401(a)-1 of Title 26 of the Code of Federal Regulations provides:

Wages.

(a) *In general.* (1) The term "wages" means all remuneration for services performed by an employee for his employer unless specifically excepted under section 3401(a) or excepted under section 3402(e).

(2) The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer.

(3) The basis upon which the remuneration is paid is immaterial in determining whether the remunera-

tion constitutes wages. Thus, it may be paid on the basis of piecework, or a percentage of profits; and may be paid hourly, daily, weekly, monthly, or annually.

(4) Generally the medium in which remuneration is paid is also immaterial. It may be paid in cash or in something other than cash, as for example, stocks, bonds, or other forms of property. (See, however, § 31.3401(a)(11)-1, relating to the exclusion from wages of remuneration paid in any medium other than cash for services not in the course of the employer's trade or business, and § 31.3401(a)(16)-1, relating to the exclusion from wages of tips paid in any medium other than cash.) If services are paid for in a medium other than cash, the fair market value of the thing taken in payment is the amount to be included as wages. If the services were rendered at a stipulated price, in the absence of evidence to the contrary, such price will be presumed to be the fair value of the remuneration received. If a corporation transfers to its employees its own stock as remuneration for services rendered by the employee, the amount of such remuneration is the fair market value of the stock at the time of the transfer.

(5) Remuneration for services, unless such remuneration is specifically excepted by the statute, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

Example. A is employed by R during the month of January 1955 and is entitled to receive remuneration of $100 for the services performed for R, the employer, during the month. A leaves the employ of R at the close of business on January 31, 1955. On February 15, 1955 (when A is no longer an employee of R), R pays A the remuneration of $100 which was earned for the services performed in January. The $100 is wages within the meaning of the statute.

(b) *Certain specific items—(1) Pensions and retirement pay.* (i) In general, pensions and retired pay are wages subject to withholding. However, no withholding is required with respect to amounts paid to an employee upon retirement which are taxable as annuities under the provisions of section 72 or 403. So-called pensions awarded by one to whom no services have been rendered are mere gifts or gratuities and do not constitute wages. Those payments of pensions or other benefits by the Federal Government under Title 38 of the United States Code which are excluded from gross income are not wages subject to withholding.

(ii) Amounts received as retirement pay for service in the Armed Forces of the United States, the Coast and Geodetic Survey, or the Public Health Service or as a disability annuity paid under the provisions of section 831 of the Foreign Service Act of 1946, as amended (22) U.S.C. 1081; 60 Stat. 1021), are subject to withholding unless such pay or disability annuity is excluded from gross income under section 104(a)(4), or is taxable as an annuity under the provisions of section

72. Where such retirement pay or disability annuity (not excluded from gross income under section 104(a)(4) and not taxable as an annuity under the provisions of section 72) is paid to a nonresident alien individual, withholding is required only in the case of such amounts paid to a nonresident alien individual who is a resident of Puerto Rico.

(2) *Traveling and other expenses.* Amounts paid specifically—either as advances or reimbursements —for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment. For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see § 31.3401 (a)-4.

(3) *Vacation allowances.* Amounts of so-called "vacation allowances" paid to an employee constitute wages. Thus, the salary of an employee on vacation, paid notwithstanding his absence from work, constitutes wages.

(4) *Dismissal payments.* Any payments made by an employer to an employee on account of dismissal, that is, involuntary separation from the service of the employer, constitute wages regardless of whether

the employer is legally bound by contract, statute, or otherwise to make such payments.

(5) *Deductions by employer from remuneration of an employee.* Any amount deducted by an employer from the remuneration of an employee is considered to be a part of the employee's remuneration and is considered to be paid to the employee as remuneration at the time that the deduction is made. It is immaterial that any act of Congress, or the law of any State or of Puerto Rico, requires or permits such deductions and the payment of the amounts thereof to the United States, a State, a Territory, Puerto Rico, or the District of Columbia, or any political subdivision of any one or more of the foregoing.

(6) *Payment by an employer of employee's tax, or employee's contributions under a State law.* The term "wages" includes the amount paid by an employer on behalf of an employee (without deduction from the remuneration of, or other reimbursement from, the employee) on account of any payment required from an employee under a State unemployment compensation law, or on account of any tax imposed upon the employee by any taxing authority, including the taxes imposed by sections 3101 and 3201.

(7) *Remuneration for services as employee of nonresident alien individual or foreign entity.* The term "wages" includes remuneration for services performed by a citizen or resident (including, in regard to wages paid after February 28, 1979, an individual treated as a resident under section 6013 (g) or

(h)) of the United States as an employee of a nonresident alien individual, foreign partnership, or foreign corporation whether or not such alien individual or foreign entity is engaged in trade or business within the United States. Any person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States (including Puerto Rico as if a part of the United States), is subject to all the provisions of law and regulations applicable with respect to an employer. See § 31.3401(d)-1, relating to the term "employer", and § 31.3401(a)(8)(C)-1, relating to remuneration paid for services performed by a citizen of the United States in Puerto Rico.

(8) *Amounts paid under accident or health plans* —(i) *Amounts paid in taxable years beginning on or after January 1, 1977*—(*a*) *In general.* Withholding is required on all payments of amounts includible in gross income under section 105(a) and § 1.105-1 (relating to amounts attributable to employer contributions), made in taxable years beginning on or after January 1, 1977, to an employee under an accident or health plan for a period of absence from work on account of personal injuries or sickness. Payments on which withholding is required by this subdivision are wages as defined in section 3401(a), and the employer shall deduct and withhold in accordance with the requirements of chapter 24 of subtitle C of the Code. Third party payments of sick pay, as defined in section 3402(o) and the regulations thereunder, are not wages for purposes of this section.

(*b*) *Payments made by an agent of the employer.* (*1*) Payments are considered made by the employer if a third party makes the payments as an agent of the employer. The determining factor as to whether a third party is an agent of the employer is whether the third party bears any insurance risk. If the third party bears no insurance risk and is reimbursed on a cost plus fee basis, the third party is an agent of the employer even if the third party is responsible for making determinations of the eligibility of individual employees of the employer for sick pay payments. If the third party is paid an insurance premium and not reimbursed on a cost plus fee basis, the third party is not an agent of the employer, but the third party is a payor of third party sick pay for purposes of voluntary withholding from sick pay under sections 3402(o) and 6051(f) and the regulations thereunder. If a third party and an employer enter into an agency agreement as provided in paragraph (c) of § 31.6051-3 (relating to statements required in case of sick pay paid by third parties), that agency agreement does not make the third party an agent of the employer for purposes of this paragraph.

(*2*) Payments made by agents subject to this paragraph are supplemental wages as defined in § 31.3402(g)-1, and are therefore subject to the rules regarding withholding tax on supplemental wages provided in § 31.3402(g)-1. For purposes of those rules, unless the agent is also an agent for purposes of withholding tax from the employee's regular wages, the agent may deem tax to have been withheld

from regular wages paid to the employee during the calendar year.

(*3*) This paragraph is only applicable to amounts paid on or after May 25, 1983 unless the agent actually withheld taxes before that date.

(*c*) *Exceptions to withholding.* (*1*) Withholding is not required on payments that are specifically excepted under the numbered paragraphs of section 3401(a) (relating to the definition of wages), under section 3402(e) (relating to included and excluded wages), or under section 3402(n) (relating to employees incurring no income tax liability).

(*2*) Withholding is not required on disability payments to the extent that the payments are excludable from gross income under section 105(d). In determining the excludable portion of the disability payments, the employer may assume that payments that the employer makes to the employee are the employee's sole source of income. This exception applies only if the employee furnishes the employer with adequate verification of disability. A certificate from a qualified physician attesting that the employee is permanently and totally disabled (within the meaning of section 105(d)) shall be deemed to constitute adequate verification. This exception does not affect the requirement that a statement (which includes any amount paid under section 105(d)) be furnished under either section 6041 (relating to information at source) or section 6051 (relating to

receipts for employees) and the regulations thereunder.

(ii) *Amounts paid after December 31, 1955 and before January 1, 1977*—(*a*) *In general.* The term "wage continuation payment", as used in this subdivision, means any payment to an employee which is made after December 31, 1955, and before January 1, 1977 under a wage continuation plan (as defined in paragraph (a)(2)(i) of § 1.105-4 and § 1.105-5 of Part 1 of this chapter (Income Tax Regulations)) for a period of absence from work on account of personal injuries or sickness, to the extent such payment is attributable to contributions made by the employer which were not includable in the employee's gross income or is paid by the employer. Any such payment, whether or not excluded from the gross income of the employee under section 105(d), constitutes "wages" (unless specifically excepted under any of the numbered paragraphs of section 3401(a) or under section 3402(e) and withholding thereon is required except as provided in paragraphs (b)(8)(ii) (*b*), (*c*), and (*d*) of this section.

(*b*) *Amounts paid before January 1, 1977, by employer for whom services are performed for period of absence beginning after December 31, 1963.* (*1*) Withholding is not required upon the amount of any wage continuation payment for a period of absence beginning after December 31, 1963, paid before January 1, 1977, to an employee directly by the employer for whom he performs

services to the extent that such payment is excludable from the gross income of the employee under the provisions of section 105(d) in effect with respect to such payments, provided the records maintained by the employer—

(*i*) Separately show the amount of each such payment and the excludable portion thereof, and

(*ii*) Contain data substantiating the employee's entitlement to the exclusion provided in section 105(d) with respect to such amount, either by a written statement from the employee specifying whether his absence from work during the period for which the payment was made was due to a personal injury or to sickness and whether he was hospitalized for at least one day during this period; or by any other information which the employer reasonably believes establishes the employee's entitlement to the exclusion under section 105(d). Employers shall not be required to ascertain the accuracy of any written statement submitted by an employee in accordance with this subdivision *(b)(1)(ii)*.

For purposes of this subdivision *(b)(1)*, wage continuation payments reasonably expected by the employer to be made on behalf of the employer by another person shall be taken into account in determining whether the 75 percent test contained in section 105(d) is met and in computing the amount of any wage continua-

tion payment made directly by the employer for whom services are performed by the employee which is within the $75 or $100 weekly rate of exclusion from the gross income of the employee provided in section 105(d). In making this latter computation, the amount excludable under section 105(d) shall be applied first against payments reasonably expected to be made on behalf of the employer by the other person and then, to the extent any part of the exclusion remains, against the payments made directly by the employer. In a case in which wage continuation payments are not paid at a constant rate for the first 30 calendar days of the period of absence, the determination of whether the 75 percent test contained in section 105(d) is met shall be based upon the length of the employee's absence as of the end of the period for which the payment by the employer is made, without regard to the effect which any further extension of such absence may have upon the excludability of the payment.

(*2*) The computation of the amount of any wage continuation payment with repect to which the employer may refrain from withholding may be illustrated by the following examples:

Example 1. A, an employee of B, normally works Monday through Friday and has a regular weekly rate of wages of $100. On Monday, November 5, 1974, A becomes ill, and as a result

is absent from work for two weeks, returing to work on Monday, November 19, 1974. A is not hospitalized. Under B's noncontributory wage continuation plan, A receives no benefits for the first three working days of absence and is paid benefits directly by B at the rate of $85 a week thereafter ($34 for the last two days of the first week of absence and $85 for the second week of absence). No wage continuation payment is made by any other person. Since the benefits are entirely attributable to contributions to the plan by B, such benefits are wage continuation payments in their entirety. The wage continuation payments for the first seven calendar days of absence are not excludable from A's gross income because A was not hospitalized for at least one day during his period of absence, and therefore B must withhold with respect to such payments. Under section 105(a), the wage continuation payments attributable to absence after the first seven calendar days of absence are excludable to the extent that they do not exceed a rate of $75 a week. Under the principles stated in paragraph (e)(6)(iv) of § 1.105-4 of this chapter (Income Tax Regulations), the wage continuation payments in this case are at a rate not in excess of 75 percent (119/200 or 59.5 percent) of A's regular weekly rate of wages. Accordingly, B may refrain from withholding with respect to $75 of the wage continuation payment attributable to the second week of absence.

Example 2. Assume the facts in example 1 except that A is unable to return to work until Monday, February 11, 1975, and that, of the $85 a week of wage continuation payments $35 is paid directly by B and $50 is reasonably expected by B to be paid by C, an insurance company, on behalf of B. In such a case, both the $50 and the $35 payments constitute wage continuation payments and the amount of such payments which is attributable to the first 30 calendar days of absence is at a rate not in excess of 75 percent (323/440 or 73.4 percent) of A's regular weekly rate of wages. Therefore, under section 105(d), the portion of such payments which is attributable to absence after the first seven calendar days of absence is excludable to the extent that it does not exceed a rate of $75 a week for the eighth through the thirtieth calendar day of absence and does not exceed a rate of $100 a week thereafter. B may refrain from withholding with repect to $25 a week (the amount by which the $75 maximum excludable amount exceeds the $50 reasonably expected by B to be paid by C) of his direct payments for the eighth through the thirtieth calendar day of absence. Thereafter, B may refrain from withholding with respect to the entire $35 paid directly by him since the maximum excludable amount ($100 a week) exceeds the total of payments made by B and payments which B reasonably expects will be made by C.

(*c*) *Amounts paid by employer for whom services are performed for period of absence beginning before January 1, 1964.* Withholding is not required upon the amount of any wage continuation payment for a period of absence beginning before January 1, 1964, made to an employee directly by the employer for whom he performs services to the extent that such payment is excludable from the gross income of the employee under the provisions of section 105(d) in effect with respect to such payments, provided the records maintained by the employer—

(*1*) Separately show the amount of each such payment and the excludable portion thereof, and

(*2*) Contain data substantiating the employee's entitlement to the exclusion provided in section 105(d) with respect to such amount, either by a written statement from the employee specifying whether his absence from work during the period for which the payment was made was due to a personal injury or whether such absence was due to sickness, and, if the latter, whether he was hospitalized for at least one day during this period; or by any other information which the employer reasonably believes establishes the employee's entitlement to the exclusion under section 105(d). Employers shall not be required to ascertain the accuracy of the information contained in any written statement submitted by an employee in accordance with

this paragraph (b)(8)(ii)(*c*)(*2*). For purposes of this paragraph (b)(8)(ii)(*c*), the computation of the amount excludable form the gross income of the employee under section 105(d) may be made either on the basis of the wage continuation payments which are made directly by the employer for whom the employee performs services, or on the basis of such payments in conjunction with any wage continuation payments made on behalf of the employer by a person who is regarded as an employer under section 3401(d)(1).

(*d*) *Amounts paid before January 1, 1977 by person other than the employer for whom services are performed.* No tax shall be withheld upon any wage continuation payment made to an employee by or on behalf of a person who is not the employer for whom the employee performs services but who is regarded as an employer under section 3401(d)(1). For example, no tax shall be withheld with respect to wage continuation payments made on behalf of an employer by an insurance company under an accident or health policy, by a separate trust under an accident or health plan, or by a State agency from a sickness and disability fund maintained under State law.

(*e*) *Cross references.* See sections 6001 and 6051 and the regulations thereunder for rules with respect to the records which must be maintained in connection with wage continuation payments and for rules with respect to the state-

ments which must be furnished an employee in connection with wage continuation payments, respectively. See also section 105 and § 1.105-4 of this chapter (Income Tax Regulations).

(9) *Value of meals and lodging.* The value of any meals or lodging furnished to an employee by his employer is not subject to withholding if the value of the meals or lodging is excludable from the gross income of the employee. See § 1.119-1 of this chapter (Income Tax Regulations).

(10) *Facilities or privileges.* Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as wages subject to withholding if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees.

(11) *Tips or gratuities.* Tips or gratuities paid, prior to January 1, 1966, directly to an employee by a customer of an employer, and not accounted for by the employee to the employer are not subject to withholding. For provisions relating to the treatment of tips received by an employee after December 31, 1965, as wages, see §§ 31.3401(f)-1 and 31.3402(k)-1.

(12) *Remuneration for services performed by permanent resident of Virgin Islands*—(i) *Exemption from withholding.* No tax shall be withheld for

the United States under chapter 24 from a payment of wages by an employer, including the United States or any agency thereof, to an employee if at the time of payment it is reasonable to believe that the employee will be required to satisfy his income tax obligations with respect to such wages under section 28(a) of the Revised Organic Act of the Virgin Islands (68 Stat. 508). That section provides that all persons whose permanent residence is in the Virgin Islands "shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands".

(ii) *Claiming exemption.* If the employee furnishes to the employer a statement in duplicate that he expects to satisfy his income tax obligations under section 28(a) of the Revised Organic Act of the Virgin Islands with respect to all wages subsequently to be paid to him by the employer during the taxable year to which the statement relates, the employer may, in the absence of information to the contrary, rely on such statement as establishing reasonable belief that the employee will so satisfy his income tax obligations. The employee's statement shall identify the taxable year to which it relates, and both the original and the duplicate copy thereof shall be signed and dated by the employee.

(iii) *Disposition of statement.* The original of the statement shall be retained by the employer.

The duplicate copy of the statement shall be sent by the employer to the Director of International Operations, Washington, D.C. 20225, on or before the last day of the calendar year in which the employer receives the statement from the employee.

(iv) *Applicability of subparagraph.* This subparagraph has no application with respect to any payment of remuneration which is not subject to withholding by reason of any other provision of the regulations in this subpart.

(13) *Federal employees resident in Puerto Rico.* Except as provided in paragraph (d) of § 31.3401(a)(6)-1, the term "wages" includes remuneration for services performed by a nonresident alien individual who is a resident of Puerto Rico if such services are performed as an employee of the United States or any agency thereof. The place where the services are performed is immaterial for purposes of this subparagraph.

(14) *Supplemental unemployment compensation benefits.* (i) Supplemental unemployment compensation benefits paid to an individual after December 31, 1970, shall be treated (for purposes of the provisions of Subparts E, F, and G of this part which relate to withholding of income tax) as if they were wages, to the extent such benefits are includible in the gross income of such individual.

(ii) For purposes of this subparagraph, 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 the employee's involuntary separation from the employment of the employer, whether or not such separation is temporary, but only when such separation is one resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions.

(iii) For the meanings of the terms "involuntary separation from the employment of the employer" and "other similar conditions", see subparagraphs (3) and (4) of § 1.501(c)(17)-1(b) of this chapter (Income Tax Regulations).

(iv) As used in this subparagraph, the term "employee" means an employee within the meaning of paragraph (a) of § 31.3401(c)-1, the term "employer" means an employer within the meaning of paragraph (a) of § 31.3401(d)-1, and the term "employment" means employment as defined under the usual common law rules.

(v) References in this chapter to wages as defined in section 3401(a) shall be deemed to refer also to supplemental unemployment compensation benefits which are treated under this subparagraph as if they were wages.

(15) *Split-dollar life insurance arrangements.* See § 1.61-22 of this chapter for rules relating to the treatment of split-dollar life insurance arrangements.

(c) *Geographical definitions.* For definition of the term "United States" and for other geographical definitions relating to the Continental Shelf see section 638 and § 1.638-1 of this chapter.