No. 00-203

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP

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

BRIEF FOR THE UNITED STATES

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QUESTION PRESENTED

Whether, for purposes of the Federal Insurance Contributions Act, 26 U.S.C. 3101-3128, and the Federal Unemployment Tax Act, 26 U.S.C. 3301-3311, an award of back wages should be attributed to the year in which the award was actually paid or, instead, to the year in which the events that gave rise to the award occurred.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-5a) is unpublished, but the decision is noted at 215 F.3d 1325 (Table). The opinion of the district court (Pet. App. 6a-11a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on May 10, 2000. The petition for a writ of certiorari was filed on August 8, 2000, and was granted on October 16, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS AND REGULATIONS INVOLVED

The relevant portions of Sections 3101, 3111, 3121, 3301, and 3306 of the Internal Revenue Code, 26 U.S.C. 3101, 3111, 3121, 3301, and 3306, and of Sections 31.3101-2(c), 31.3101-3, 31.3111-2(c), 31.3111-3, 31.3121(a)-2, 31.3121(a)(1)-1(a)(2), 31.3301-2, and 31.3306(b)(1)-1 of the Treasury Regulations on Employment Taxes and Collection of Income Tax at Source, 26 C.F.R. 31.3101-2(c), 31.3101-3, 31.3111-2(c), 31.3111-3, 31.3121(a)-2, 31.3121(a)(1)-1(a)(2), 31.3301-2, and 31.3306(b)(1)-1, are set forth at J.A. 21-30.

STATEMENT

1. Respondent is one of 26 major league baseball clubs that are parties to a collective bargaining agreement negotiated with the Major League Baseball Players Association. Pet. App. 7a. The players association filed grievances claiming that, in 1986, 1987, and 1988, the clubs violated the free agency rights of the players under the collective bargaining agreement. *Id.* at 2a, 7a. An arbitration panel issued rulings in 1990 concluding that the clubs had interfered with the players' free agency rights and thereby depressed the players' salaries. To settle these grievances, the clubs agreed to pay $280 million into two accounts administered by a custodian for distribution to the players who had suffered damages. *Ibid.* The custodian was required to establish separate accounts for each of the clubs and, acting as agent for the clubs, was to deduct from the settlement payments any applicable federal income or employment taxes required to be withheld. J. A. 24; C.A. App. 37.

Under the agreed distribution plan, eight players who were employees of respondent during 1986, and

fourteen players who were employees of respondent during 1987, received awards. The awards were paid in 1994. Pet. App. 3a, 7a.[1] These payments aggregated $829,638 (including $219,638 denominated as interest) for violations of the collective bargaining agreement occurring in 1986 and $1,866,967 (including $409,119 denominated as interest) for violations occurring in 1987. *Id.* at 2a, 8a; J.A. 26; C.A. App. 11-12.

2. As part of the Federal Insurance Contributions Act (FICA), Section 3101(a) and (b) of the Internal Revenue Code "impose[] on the income of every individual" taxes to fund Social Security and Medicare "equal to [a percentage] of the wages (as defined in section 3121(a)) received by him with respect to employment." 26 U.S.C. 3101(a), (b). Similarly, Sections 3111(a) and (b) "impose[] on every employer" taxes to fund Social Security and Medicare "equal to [a percentage] of the wages (as defined in section 3121(a)) paid by him with respect to employment." 26 U.S.C. 3111(a), (b). For both employers and employees, the percentage of wages to be paid as Social Security tax under Sections 3101(a) and 3111(a) was 5.7 percent in 1986 and 1987 and rose to 6.2 percent by 1994. 26 U.S.C. 3101(a), 3111(a). The percentage of wages paid by employers and employees as the Medicare tax under Sections 3101(b) and 3111(b) has been 1.45 percent since 1986. 26 U.S.C. 3101(b), 3111(b).

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[1] One player who was not actually employed by respondent during 1987 also received an award in 1994 that was treated as attributable to 1987 under the settlement arrangement. The district court stated that this was because, even though "he was no longer in baseball in 1994, he was 'deemed' an employee of the last team to employ him—the Indians." Pet. App. 7a n.1.

The term "wages" is defined for purposes of the Social Security tax provisions (Sections 3101(a) and 3111(a)) to mean "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash," with certain exceptions. 26 U.S.C. 3121(a). As relevant here, wages do *not* include "that part of the remuneration which, after remuneration * * * 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." 26 U.S.C. 3121(a)(1).[2] This definition of wages also applied for purposes of Sections 3101(b) and 3111(b) in 1986 and 1987. 26 U.S.C. 3121(a) (1982 & Supp. III 1985). By 1994, however, when the settlement award payments were made in this case, "wages" had been defined so that the exclusion for amounts in excess of the contribution and benefit base no longer applied for purposes of the Medicare tax provisions (Sections 3101(b) and 3111(b)). See 26 U.S.C. 3121(a)(1).

In addition, as part of the Federal Unemployment Tax Act (FUTA), Section 3301 "impose[s] on every employer * * * for each calendar year an excise tax, with respect to having individuals in his employ, equal

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[2] The contribution and benefit base is a fixed dollar amount for a particular year determined under the formula contained in Section 230 of the Social Security Act, 42 U.S.C. 430. In 1994, the base was $60,600. 58 Fed. Reg. 58,004 (1993). In 1986, the base was $42,000. 50 Fed. Reg. 45,559 (1985). In 1987, it was $43,800. 51 Fed. Reg. 40,257 (1986).

to * * * [a percentage] of the total wages * * * paid by him during the calendar year with respect to employment * * * ." 26 U.S.C. 3301. During the relevant years, the applicable percentage of wages constituting this tax was 6.2 percent. *Ibid.* The term "wages" is defined for purposes of Section 3301 in the same manner as in Section 3121(a), except "wages" for unemployment tax purposes do not include "remuneration * * * after * * * equal to $7,000 with respect to employment has been paid to an individual by an employer during any calendar year * * * ." 26 U.S.C. 3306(b).

3. When the amounts awarded to respondent's players were paid in 1994, FICA and income taxes were withheld by the custodian, on behalf of respondent, from the amounts paid.[3] Respondent thereafter filed an employment tax return for the first quarter of 1994. That return reported employer and employee FICA taxes attributable to the settlement payments based on the entire amount of the awards made in 1994 and using the rates and annual ceilings on wages in effect for the 1994 year. Pet. App. 2a-3a, 7a-8a; J.A. 26-27; C.A. App. 13, 28. Respondent also filed a return for the calendar year 1994 that reported FUTA taxes attributable to the settlement payments, again based on the entire amount of the awards made in 1994 and using the rates and annual ceilings on wages in effect for the 1994 year. Pet. App. 2a-3a, 7a-8a. Having remitted the withheld taxes, respondent filed a claim for refund that sought to recover both the employer's share of the FICA and FUTA taxes it paid *and* the FICA taxes withheld from

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[3] Pursuant to 26 U.S.C. 3102, 3402, employers are generally required to withhold from the wages of their employees the employee's share of the FICA tax and income taxes.

those employees who consented to join in the claim. C.A. 93. When the claim for refund was not granted within six months, respondent filed this tax refund suit in district court to recover the employer's share of the FICA taxes and the FUTA taxes that it paid. Pet. App. 3a, 8a.[4]

Respondent raised several claims. First, respondent asserted that a portion of the award paid in 1994 was "interest," which is not subject to employment tax. Second, respondent asserted that the non-interest portion of the award paid in 1994 did not constitute "wages" within the meaning of the employment tax statutes. And, third, respondent asserted that, if any portion of the award paid in 1994 constituted "wages," it should be attributed for FICA and FUTA tax purposes to 1986 or 1987 (when the annual wage ceiling had been exceeded by each of the affected players), rather than to 1994, when the awards were paid. As a result, respondent claimed that no FICA or FUTA taxes were due from the 1994 awards. Pet. App. 3a.

The parties stipulated (i) that the "interest" portion of the awards paid in 1994 did not constitute "wages" and (ii) that the remainder of those awards constituted back wages for the years 1986 and 1987. Pet. App. 3a-4a. The parties then filed cross-motions for summary judgment that presented a single issue—whether, for FICA and FUTA tax purposes, the back wages paid by respondent are attributable to 1994, the year in which they were paid, or to 1986 and 1987, the years in which they would have been earned but for respondent's breach of the collective bargaining agreement. *Id.* at 4a, 6a, 9a.

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[4] In this suit, respondent does not seek to recover the employee share of the FICA taxes. C.A. App. 7-18.

4. The government acknowledged in its brief to the district court that the prior decision of the Sixth Circuit in *Bowman* v. *United States*, 824 F.2d 528, 530 (1987), was controlling precedent on the issue in that court. In *Bowman*, the Sixth Circuit held that for FICA tax purposes, "[a] settlement for back wages should not be allocated to the period when the employer finally pays but should be allocated to the periods when the regular wages were not paid as usual." *Id.* at 530 (internal quotation marks and citation omitted). Because other circuits have disagreed with the reasoning and holding of *Bowman*, however, the government's brief explained to the district court that the government desired to preserve that issue for appeal. Pet. App. 10a. Acknowledging that "at least one court has disagreed with *Bowman*," the district court concluded that judgment in favor of the respondent was "dictated" by the Sixth Circuit precedent that was controlling in that court. *Id.* at 10a-11a.

5. The government appealed and filed a petition for hearing en banc in view of the circuit conflict. The court of appeals denied the petition and referred the case to a panel of the court. Pet. App. 4a.

The panel affirmed. Pet. App. 1a-5a. The panel noted that the government argued that the plain language of the FICA and FUTA statutes, the legislative history of those provisions, and the pertinent Treasury Regulations all demonstrate that *Bowman* was incorrectly decided and that "the government cites cases from our sister circuits that are at odds with our *Bowman* holding." *Id.* at 5a. The panel stated, however, that it was not required to address the merits of the government's contentions because, "[e]ven if we were persuaded by the government's argument, we are bound by the *Bowman* decision." *Ibid.*

SUMMARY OF ARGUMENT

1. Sections 3111(a) and (b) of the Internal Revenue Code impose the FICA taxes that fund Social Security and Medicare on "wages * * * paid" during the calendar year. Section 3301(a) similarly imposes the FUTA tax on "wages * * * paid * * * during the calendar year." No exception to this express statutory rule is created for back wages. Under the plain language of these statutes, back wages are taxed in the year in which they are paid and *not* in the year in which the services were performed or would have been performed but for the wrongful conduct of the employer.

The legislative history of the pertinent statutory provisions shows that Congress specifically intended wages to be taken into account in the year that they are paid, regardless of when earned or when owed by the employer. When Congress originally enacted these employment taxes in 1935, they were imposed "with respect to employment during the calendar year[]." Social Security Act, ch. 531, §§ 801, 804, 49 Stat. 636-637. In 1939, however, Congress amended the FICA and FUTA statutes to provide that the rate of tax would no longer be applied on the basis of when the services were performed but would instead be applied "[w]ith respect to wages received during the calendar year[]" in the case of the employee and "[w]ith respect to wages paid during the calendar year[]" in the case of the employer. Social Security Act Amendments of 1939, ch. 666, §§ 601, 604, 53 Stat. 1382-1383. Similarly, in 1946, a corresponding change was made to the provisions that place an annual ceiling on the amount of wages subject to FICA and FUTA tax to change the basis upon which the ceiling was measured from one that looked to services performed to one that looked at

wages paid during the year. Social Security Act Amendments of 1946, ch. 951, §§ 412(a), (b), 60 Stat. 989.

Consistent with the language of these statutes and their legislative history, Treasury Regulations have long specified that the relevant year for determining the FICA and FUTA taxes is the year in which the wages are paid or received. Applying the plain language of these statutes and regulations, the Treasury has consistently taken the position in its Revenue Rulings that back wages are to be taken into account for FICA and FUTA tax purposes in the year they are actually paid. Such "Treasury regulations and interpretations long continued without substantial change * * * are deemed to have received congressional approval and have the effect of law." *Cottage Sav. Ass'n* v. *Commissioner*, 499 U.S. 554, 561 (1991).

2. The decision in *Bowman* v. *United States*, 824 F.2d 528, 530 (6th Cir. 1987), upon which the court of appeals based its decision in this case, is fundamentally flawed. The *Bowman* court failed to address the plain text of the statute, and its clear legislative history, which demonstrates that Congress did not intend to allocate back wages to the year in which the services were performed. Instead, the court in *Bowman* based its holding that back wages are to be allocated to the year in which the services were performed solely on the theory that this result is required by this Court's decision in *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946). In *Nierotko*, the issue was whether back pay awarded to an employee was to be treated, for benefit purposes, as "wages" under the original provisions of the Social Security Act of 1935 which defined that term as "remuneration * * * with respect to employment during any calendar year." Social Security

Act, ch. 531, § 210(a), 49 Stat. 625. See 327 U.S. at 360. The Court held in *Nierotko* that, for benefit computation purposes, back pay constitutes "wages" and should be allocated to "the periods when the regular wages were not paid as usual." 327 U.S. at 370.

In 1946, however, Congress amended the Social Security Act to change the annual "wage" ceiling for benefit computation purposes, just as it had done for the FICA and FUTA tax provisions. For "remuneration * * * with respect to employment * * * paid to an individual during any calendar year after 1946," the annual wage ceiling was to be based upon "remuneration * * * *paid* to such individual *during such calendar year*." Social Security Act Amendments of 1946, ch. 951, § 414(a)(3), 60 Stat. 991 (emphasis added). The statutory scheme considered in *Nierotko* thus obviously differed in this precise critical respect from the statutory provisions that have been in effect since 1946—the provisions that are involved in this case. Moreover, any suggestion that the statutory provisions that applied for benefit purposes in *Nierotko* should be applied for FUTA and FICA tax purposes in years following the 1946 amendments is contradicted by the decision of this Court in *Otte* v. *United States*, 419 U.S. 43 (1974). In *Otte*, the Court pointed out that, under the provisions that apply for years after 1946, "the tax is to be collected by the employer by deducting 'from the wages as and when paid.'" *Id.* at 51. As the Fourth Circuit concluded in *Hemelt* v. *United States*, 122 F.3d 204, 210 (1997), and the Tenth Circuit concluded in *Walker* v. *United States*, 202 F.3d 1290, 1292-1293 (2000), the court below erred in *Bowman* in relying on *Nierotko* and in refusing to consider the plain text and clear history of the applicable FICA and FUTA tax provisions.

ARGUMENT

FOR FICA AND FUTA TAX PURPOSES, AN AWARD OF BACK WAGES IS TO BE ATTRIBUTED TO THE YEAR IN WHICH THE AWARD IS ACTUALLY PAID, AND NOT TO THE YEAR OR YEARS IN WHICH THE EVENTS OCCURRED THAT GAVE RISE TO THE AWARD

A. The Plain Language Of The Relevant Statutes, Their Legislative History, And The Applicable Treasury Regulations Demonstrate That Back Wages Are To Be Attributed To The Year Of Payment For FICA And FUTA Tax Purposes

Under a settlement resolving player grievances, respondent paid back wages to its players in 1994 for services that were performed in 1986 and 1987. The court of appeals erred in holding that these back wages should be allocated for FICA and FUTA tax purposes to the years in which the wages were earned or should have been paid rather than to the year in which they actually were paid. Pet. App. 4a-5a.[5] Sections 3111(a)

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[5] The statutory provisions involved in this case are set forth in the Federal Insurance Contributions Act (FICA), Chapter 21, Internal Revenue Code of 1986, 26 U.S.C. 3101-3128, and the Federal Unemployment Tax Act (FUTA), Chapter 23, Internal Revenue Code of 1986, 26 U.S.C. 3301-3311. These Acts serve to fund two major social initiatives that were enacted as part of the Social Security Act, ch. 531, 49 Stat. 620 (1935), as amended, 42 U.S.C. 301-1397jj. See generally, W. Cohen, *The Development of the Social Security Act of 1935: Reflections Some Fifty Years Later*, 6 Soc. Sec. Rep. Ser. 933, 933-934 (1984). The FICA tax funds the Federal Old Age, Survivors, Disability and Hospital Insurance Programs, commonly known as Social Security and

and (b) of the Internal Revenue Code impose the FICA taxes that fund Social Security and Medicare on "wages * * * paid" during the calendar year and Section 3301(a) imposes the FUTA tax on "wages * * * paid * * * during the calendar year." No exception to this express statutory rule is created for back wages. Under the plain language of these statutes, back wages are taxed in the year in which they are paid and not in the year in which the services were performed or would have been performed but for the wrongful conduct of the employer. The extensive legislative history of these provisions, and the consistent rulings and regulations of the Treasury, confirm that, under the plain text of these statutes, back wages must be attributed for FICA and FUTA purposes to the year in which the wages are actually paid.

Medicare. The FUTA tax funds a federal-state unemployment compensation program. *Ibid.*

The amount of wages that are subject to the FICA and FUTA taxes for a particular year are limited by statute. See 26 U.S.C. 3121(a)(1) (providing an annual ceiling on the "wages" subject to tax under Sections 3111(a) and 3101(a)); 26 U.S.C. 3306(b)(1) (providing an annual ceiling on the "wages" that are subject to tax under 26 U.S.C. 3301). The amount of wages subject to the FICA Medicare taxes imposed by 26 U.S.C. 3101(b) and 3111(b) was also limited for the years 1986 and 1987 (26 U.S.C. 3121(a)(1) (1982)), but there was no limit on the amount of "wages" used in computing the Medicare tax for 1994. 26 U.S.C. 3121(a)(1). The applicable rates of tax can also vary from year to year. See 26 U.S.C. 3101, 3111, 3301. Determining the proper year in which to attribute "wages" for FICA and FUTA tax purposes thus often has meaningful tax consequences.

1. *The FICA Provisions*

a. Section 3101(a) of the Internal Revenue Code imposes the FICA tax on the wages received by an employee during the calendar year. It states (26 U.S.C. 3101(a) (emphasis added)):

> 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. |

Section 3111(a) similarly imposes the FICA tax on the wages paid by employers during the calendar year. It states (26 U.S.C. 3111(a) (emphasis added)):

> there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of *the wages* (as defined in section 3121(a)) *paid by him* with respect to employment (as defined in section 3121(b))—
>
> | In cases of *wages paid 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. |

The provisions that impose the employee and employer Medicare taxes (26 U.S.C. 3101(b), 3111(b)) are similarly worded and also apply to "wages received during" and "wages paid during" the relevant tax year. In

addition, pursuant to 26 U.S.C. 3102(a), the employer is to deduct the employee's portion of the FICA tax "from the wages as and when paid." Under the plain text of these provisions, (i) the FICA tax is determined by applying the rate in effect during the year to the wages paid or received during that year and (ii) the amount of tax thus determined is to be deducted from the employee's wages in the year the wages are paid.

Section 3121(a)(1) imposes the annual ceiling on the amount of wages to which the FICA tax applies. That ceiling also explicitly applies to the year that the wages are paid and not to the year of employment. It specifies that "wages" for purposes of 26 U.S.C. 3101(a) and 3111(a) do not include (26 U.S.C. 3121(a)(1) (emphasis added)):[6]

> *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.

b. The legislative history of these FICA provisions shows that Congress specifically intended wages to be taken into account in the year that they are paid, regardless of when earned or when owed by the employer. As originally enacted in 1935, the Social Security Act provided that FICA tax rates, which

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[6] Similarly, 26 U.S.C. 6413(c)(1) provides a credit for excess FICA taxes paid on the "wages received" by an employee.

gradually increased over the period from 1937 through 1948, applied "with respect to employment during the calendar year[]." Social Security Act of 1935, ch. 531, §§ 801, 804, 49 Stat. 636-637. Interpreting this language from the 1935 Act, the original Treasury regulations specified that "[t]he employees' tax is computed by applying to the wages received by the employee *the rate in effect at the time of the performance of the services* for which the wages were received" (Treas. Reg. 91, Art. 202 (1936) (emphasis added)) and that "[t]he employers' tax is computed by applying to the wages paid by the employer *the rate in effect at the time of the performance of the services* for which the wages were paid" (Treas. Reg. 91, Art. 302 (1936) (emphasis added)).

In 1939, however, Congress amended FICA expressly to provide that the tax would no longer be applied on the basis of when the services were performed but would instead be applied "[w]ith respect to wages *received* during the calendar year[]" in the case of the employee and "[w]ith respect to wages *paid* during the calendar year[]" in the case of the employer. Social Security Act Amendments of 1939, ch. 666, §§ 601, 604, 53 Stat. 1382-1383 (emphasis added). The Report of the Committee on Ways and Means explained this change as follows:

> A further change is made by this amendment. *Sections 1400 and 1410 of the Internal Revenue Code [the predecessors of 26 U.S.C. 3101 and 3111] now provide that the rate of tax applicable to wages is the rate in effect at the time of the performance of the services for which the wages are paid.* This will unnecessarily complicate the making of returns and the collection of the taxes in later years when the

> rate of tax has been increased. For example, in 1943 the rate of tax increases from 1 percent to 2 percent. Thus, wages which are paid in 1943 for services performed in 1942 will be subject to the 1-percent rate, while wages paid in 1943 for services performed in that year will be subject to the 2-percent rate. Provision must therefore be made in the return for 1943 for the reporting of wages subject to the different rates, and, in auditing the returns, it will be necessary to ascertain not merely the time when the wages were paid and received, but also the year of the rendition of the services for which the wages are paid. If employers have failed to make the proper distinction, many refunds and additional assessments will doubtless be necessary and confusion will result. *Under the amendment the rate applicable would be the rate in effect at the time that the wages are paid and received without reference to the rate which was in effect at the time the services were performed.*

H.R. Rep. No. 728, 76th Cong., 1st Sess. 57-58 (1939) (emphasis added). See also S. Rep. No. 734, 76th Cong., 1st Sess. 70-71 (1939).[7]

The legislative history of the parallel changes in the provisions that establish the annual ceiling on wages subject to the FICA tax (currently in 26 U.S.C.

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[7] In enacting this new rule, Congress emphasized that, "[w]ith both the old-age-insurance tax [FICA] and the unemployment-compensation tax [FUTA] on the wages paid basis, the keeping of records by employers will be simplified." S. Rep. No. 734, *supra*, at 76; H.R. Rep. No. 728, *supra*, at 62-63. Following enactment of these amendments, the relevant Treasury Regulations were re-written to reflect this change in the statute. See Treas. Reg. 106 §§ 402.302, 402.402 (1940); page 19 & note 10, *infra*.

3121(a)(1)) also reflects the clear intent of Congress that the FICA taxes are to be determined on a wages-paid basis.[8] As originally enacted in 1935, the Social Security Act allocated wages to the year in which services were performed in applying the annual FICA tax wage ceiling. Social Security Act of 1935, ch. 531, § 811(a), 49 Stat. 639. In 1946, Congress amended that annual ceiling provision to change the basis upon which the ceiling is measured from services performed during the year to wages paid during the year.[9] Social Security Act Amendments of 1946, ch. 951, § 412(a), 60 Stat. 989. The reports of the Senate Finance Committee and the House Committee on Ways and Means explained that, "[u]nder the definition of the term contained in existing law there is excluded from 'wages', for [FICA and FUTA tax] purposes, all remuneration with respect to employment during any calendar year paid to an individual by an employer (irrespective of the year of payment) after

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[8] When Congress has determined that a particular type of wages should be excepted from the general rule that attributes them to the year in which they are paid or received, it has done so by special rule. Congress created a special timing rule for compensation attributable to certain nonqualified deferred compensation plans in 26 U.S.C. 3121(v)(2) and 3306(r)(2). Under that special rule, this specific type of compensation is "taken into account for purposes of this chapter as of the later of * * * when the services are performed, or * * * when there is no substantial risk of forfeiture of the rights to such amount." 26 U.S.C. 3121(v)(2). No similar special timing rule for "back wages" has been enacted by Congress.

[9] Subsequent to the enactment of the Social Security Act of 1935, Congress enacted the Internal Revenue Code of 1939 and incorporated the FICA tax provisions in it. The annual wage ceiling provision was designated as Code Section 1426(a)(1). 26 U.S.C. 1426(a)(1) (1940).

remuneration equal to $3,000 has been paid to such individual by such employer with respect to employment during such year." S. Rep. No. 1862, 79th Cong., 2d Sess. 35 (1946); H.R. Rep. No. 2447, 79th Cong., 2d Sess. 35 (1946). These reports explained that the new legislation "amends such definitions, effective January 1, 1947, to constitute as the yardstick *the amount paid during the calendar year* (with respect to employment to which the taxes under the code are applicable), *without regard to the year in which the employment occurred*." S. Rep. No. 1862, *supra*, at 35 (emphasis added); H.R. Rep. No. 2447, *supra*, at 35 (emphasis added). These reports concluded that, "in applying the $3,000 limitation on wages, *the employer, employee, and those administering the taxes, may, beginning with the calendar year 1947, look only to the amount of remuneration paid* by the employer to the employee *during the calendar year*, and exclude all remuneration paid during the calendar year after $3,000 has been paid during the year with respect to * * * the employment with respect to which the taxes imposed by * * * the Federal Insurance Contributions Act are applicable[]." S. Rep. No. 1862, *supra*, at 36 (emphasis added); H.R. Rep. No. 2447, *supra*, at 35 (emphasis added).

After these various amendments were enacted in 1939 and 1946, the FICA and FUTA tax provisions were recodified in the Internal Revenue Code of 1954 and given their current section numbers. "No substantive changes," however, were made in these provisions. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A324 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 482 (1954). Although the applicable tax rates and the amounts of the annual wage ceilings have scaled upward since the enactment of the 1954 Code, the FICA and FUTA provisions involved in this case have remained sub-

stantially the same since 1946. See 26 U.S.C. 3101, 3111, 3121(a).

c. In accordance with the language of the amended statutes and their legislative history, Treasury regulations have consistently specified that the relevant year for determining the FICA tax is the year in which the wages are paid or received.[10] These regulations expressly provide that "[t]he employee tax attaches at the time that the wages are received by the employee" (26 C.F.R. 31.3101-3) and that "[t]he employee tax is computed by applying to the wages received by the employee the rate in effect at the time such wages are received" rather than during "the year in which the services were performed" (26 C.F.R. 31.3101-2(c) & Example). The regulations further specify that "[t]he employer tax attaches at the time that the wages are paid by the employer" (26 C.F.R. 31.3111-3) and that "[t]he employer tax is computed by applying to the wages paid by the employer the rate in effect at the time such wages are paid" (26 C.F.R. 31.3111-2(c)).[11] The regulations that interpret the statutory annual

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[10] In 1960, the Treasury Regulations governing FICA and FUTA were consolidated and republished with their current section numbers. T.D. 6516, 25 Fed. Reg. 13,032 (Dec. 20, 1960). The substance of these regulations traces back to earlier promulgations. See Treas. Reg. 107 (as amended by T.D. 5566, 1947-2 C.B. 148); Treas. Reg. 106 (as amended by T.D. 5566, 1947-2 C.B. 148); Treas. Reg. 106 (1940), §§ 402.301, 402.302, 402.303, 402.401, 402.402, 402.403.

[11] These regulations further provide that, "[i]n general, wages are received by an employee at the time that they are paid by the employer to the employee. Wages are paid by an employer at the time that they are actually or constructively paid unless under paragraph (c) of this section [which concerns specified types of minor cash payments that are not involved in this case] they are deemed to be subsequently paid." 26 C.F.R. 31.3121(a)-2(a).

ceiling on the amount of wages subject to the FICA tax (26 U.S.C. 3121(a)(1) further provide that this limitation "relates to the *amount of remuneration received during any 1 calendar year* for employment after 1946 *and not to the amount of remuneration for employment performed* in any 1 calendar year." 26 C.F.R. 31.3121(a)(1)-1(a)(2) (emphasis added). In numerous Revenue Rulings that have been issued to apply these statutes and regulations in specific contexts, the Treasury has consistently concluded that back wages are to be taken into account for FICA purposes in the year that they are actually paid, regardless of when earned or owed. Rev. Rul. 55-203, 1955-1 C.B. 114, 115; Rev. Rul. 89-35, 1989-1 C.B. 280; see also Rev. Rul. 78-336, 1978-2 C.B. 255; Rev. Rul. 1957-92, 1957-1 C.B. 306, 307.

It is well established that "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." *Cottage Sav. Ass'n* v. *Commissioner*, 499 U.S. 561 (1991) (internal quotation marks and citations omitted); see also *Atlantic Mutual Ins. Co.* v. *Commissioner*, 523 U.S. 382, 389 (1998). This Court has made clear that "[t]he role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner." *United States* v. *Correll*, 389 U.S. 299, 307 (1967). See also *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979). "Because the rule challenged here has not been shown deficient on that score, the Court of Appeals should have sustained its validity." *United States* v. *Correll*, 389 U.S. at 307.

2. *The FUTA Provisions*

a. The text, history, and administrative interpretation of the FUTA tax provisions parallels that of the FICA provisions just described. Section 3301 of the Internal Revenue Code imposes the FUTA tax on the wages paid by an employer during the calendar year. It states (26 U.S.C. 3301 (emphasis added)):

> There is hereby imposed on every employer (as defined in section 3306(a)) for each calendar year an excise tax, with respect to having individuals in his employ, equal to—
>
> (1) 6.2 percent in the case of calendar years 1988 through 2007; or
>
> (2) 6.0 percent in the case of calendar year 2008 and each calendar year thereafter;
>
> of the total *wages* (as defined in section 3306(b)) *paid by him during the calendar year* with respect to employment (as defined in section 3306(c)).

Section 3306(b)(1) imposes the annual ceiling on the amount of wages to which the FUTA tax applies. That ceiling also explicitly applies to the year that the wages are paid and not to the year of employment. It specifies that "wages" for purposes of 26 U.S.C. 3301 do not include (26 U.S.C. 3306(b)(1) (emphasis added)):

> *that part of the remuneration* which, *after remuneration* (other than remuneration referred to in the succeeding paragraphs of this subsection) *equal to $7,000 with respect to employment has been paid to an individual by an employer during any calendar year*, is paid to such individual by such employer during such calendar year.

Thus, as with the FICA provisions, the plain language of the FUTA provisions imposes the tax in the year in which the wages are paid or received, and does not allocate wages to the year in which the services generating the wages were performed.

b. The legislative history of the FUTA provisions also demonstrates that Congress expressly intended wages to be taken into account in the year that they are paid, regardless of when earned or when owed by the employer. As originally enacted in 1935, the Social Security Act provided that FUTA tax rates, which gradually increased from 1 percent to 3 percent over the period from 1936 through 1938, applied "[w]ith respect to employment during the calendar year." Social Security Act, ch. 531, § 901, 49 Stat. 639. In 1939, however, Congress amended the FUTA tax provisions (in the same manner that it amended the FICA provisions) to provide that the rate of tax would no longer be applied with respect to "employment during the calendar year" but would instead be applied to "wages * * * paid by [an employer] during the calendar year * * * ." Social Security Act Amendments of 1939, ch. 666, § 608, 53 Stat. 1387. The reports of the Senate Finance Committee and the House Committee on Ways and Means explained that this 1939 amendment was adopted to make the FUTA tax applicable to "wages paid" rather than "wages payable" and thus paralleled the change made at the same time to the FICA tax which, under the 1939 amendments, "also imposes a tax on 'wages paid.'" S. Rep. No. 734, *supra*, at 75; H.R. Rep. No. 728, *supra*, at 62. These reports explain that (S. Rep. No. 734, *supra*, at 75-76 (emphasis added)):

> *Under the existing law* wages are "payable" with respect to employment during a calendar year, even though the amount of wages is not fixed and no right exists to enforce payment at any time during that year. Thus *a bonus paid in 1939 for services performed in 1938 constitutes "wages payable" for 1938, even though the amount of the bonus may not have been known in 1938 and no obligation to pay it existed in that year.*
>
> In cases in which remuneration for services of an employee in a particular year is based on a percentage of profits, or on future royalties, the amount of which cannot be determined until long after the close of the year, the employer has been required to estimate unascertained amounts and pay taxes and contributions on that basis. If he has overestimated, subsequent corrections on the return must be made with consequent refunds. If the employer has underestimated, additional taxes may become due and he may also be compelled to pay additional State contributions, which are usually not allowable as credit because not timely paid. *The attendant difficulties and confusion cause a burden on employers and administrative authorities alike. The placing of this tax on the "wages paid" basis will relieve this situation.*
>
> *With both the old-age-insurance tax [FICA] and the unemployment-compensation tax [FUTA] on the wages paid basis, the keeping of records by employers will be simplified.*

The legislative history of the wage ceiling that applies to the FUTA tax (currently codified at 26 U.S.C. 3306(b)(1)) further confirms that this tax is to be

calculated and determined on a wages-paid basis. As originally enacted in 1935, the Social Security Act placed no ceiling on the wages subject to this tax. Social Security Act of 1935, ch. 531, §§ 901, 907(b), 49 Stat. 639-642. In 1939, however, Congress amended the definition of wages for FUTA purposes to impose an annual ceiling that tracked the annual wage ceiling applicable under the FICA—which at that time measured the ceiling by the wages for services performed in the calendar year. See page 17, *supra*. When Congress amended the annual wage ceiling on the FICA tax in 1946 to place it on a wages-paid basis (see *ibid.*), Congress made a parallel amendment to the FUTA wage ceiling "to effect a corresponding change." S. Rep. No. 1862, *supra*, at 36; H.R. Rep. No. 2447, *supra*, at 35; see Social Security Act Amendments of 1946, ch. 951, § 412(b), 60 Stat. 989 (amending the FUTA wage ceiling).

c. The Treasury regulations interpreting FUTA have long specified that this tax is to be determined by allocating wages to the year in which they are paid, regardless when those wages were earned or were owed by the employer. These regulations specify that "[t]he tax for any calendar year is measured by the amount of wages paid by the employer during such year" (26 C.F.R. 31.3301-2) and that "[t]he tax is computed by applying to the wages paid in a calendar year * * * the rate in effect at the time the wages are paid" (26 C.F.R. 31.3301-3(b)). The regulations that interpret the statutory annual ceiling on wages subject to FUTA (26 U.S.C. 3306(b)(1)) also expressly provide that the ceiling applies "to the *amount of remuneration paid during any one calendar year* for employment after 1938, *and not to the amount of remuneration for employment performed in any one calendar year*."

26 C.F.R. 31.3306(b)(1)-1(a)(2) (emphasis added).[12] Because these regulations conform to the plain text and history of these statutes, and thus undoubtedly "implement the congressional mandate in some reasonable manner," the agency's interpretation should have been sustained by the court of appeals. *United States* v. *Correll*, 389 U.S. at 307.

B. The Bowman Case, On Which The Court Of Appeals Based Its Decision, Was Wrongly Decided

In the present case, the court of appeals did not consider or address the agency's consistent interpretation of these controlling statutory provisions. Nor did the court provide any analysis or discussion of the text of the statutes or their legislative history. Instead, the Sixth Circuit rejected the government's position solely on the basis of that court's prior decision in *Bowman*. Pet. App. 5a. In *Bowman*, however, the court had *also* failed to address the clear statutory text and legislative history that demonstrates that, after 1946, Congress did not intend to allocate wages to the year in which services were performed. The court in *Bowman* also failed to address or consider the deference due to the

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[12] These regulations state that, in applying the annual ceiling, "the term 'wages' does not include that part of the remuneration paid within any calendar year by an employer to an employee which exceeds the first $3,000 of remuneration * * * paid within such calendar year by such employer to such employee for employment performed for him at any time after 1938." 26 C.F.R. 31.3306(b)(1)-1(a)(1). Since these regulations were issued, the annual wage ceiling has been raised by statute to $7,000. See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 271(a), 96 Stat. 554; Unemployment Compensation Amendments of 1976, Pub. L. No. 94-566, § 211(a), 90 Stat. 2676; Employment Security Amendments of 1970, Pub. L. No. 91-373, § 302, 84 Stat. 713.

interpretation of these statutes set forth in the consistent and longstanding Treasury regulations. Instead, in *Bowman*, the court of appeals based its holding that back wages are to be allocated to the years in which services were performed, rather than to the year in which the back wages were paid, solely on the theory that that result is required by the decision of this Court in *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946). See 824 F.2d at 530. The decision in *Nierotko*, however, does not support the erroneous holding of the court of appeals.

1. The *Nierotko* case involved an application of the Social Security Act provisions that predated the changes made to these statutes by Congress in 1946. In *Nierotko*, an employee was awarded "back pay" under the National Labor Relations Act for the period from February 2, 1937, to September 25, 1939, for being wrongfully discharged due to his union activities. The back pay was paid on July 18, 1941. The principal issue for decision was whether that back pay was to be treated as "wages" in determining the employee's entitlement to benefits under the Social Security Act of 1935.[13] The Court first concluded that back pay constitutes "wages" for purposes of the Act. 327 U.S. at 360-370. The Court then stated that, "[i]f, as we have held above, 'back pay' is to be treated as wages, we have no doubt that it should be allocated to the periods

[13] The definition of "wages" for benefit purposes that was at issue in *Nierotko* appeared in Title II of the Social Security Act of 1935. Social Security Act of 1935, ch. 531, § 210(a), 49 Stat. 625. This provision mirrored the definition of "wages" for Social Security tax purposes which appeared in Title VIII of the 1935 Act. Social Security Act of 1935, ch. 531, § 811(a), 49 Stat. 639.

when the regular wages were not paid as usual." *Id.* at 370.

The *Nierotko* case was decided under the original provisions of the Social Security Act of 1935 that defined "wages" as "remuneration for employment," subject to a $3,000 wage ceiling "with respect to employment during any calendar year."[14] Social Security Act, ch. 531, § 210(a), 49 Stat. 625. See 327 U.S. at 360. The term "employment" was further defined in that Act as "any service * * * performed * * * by an employee for his employer." Social Security Act, ch. 531, § 210(b), 49 Stat. 625. The statute applied in *Nierotko* thus used services performed, rather than payments received, to define the annual wage ceiling for benefit purposes. See page 17, *supra*.

In 1946, Congress amended the Social Security Act to change the annual "wage" ceiling for the FICA and FUTA tax provisions and for benefit purposes as well. Under the new statute, for "remuneration * * * with respect to employment * * * paid to an individual during any calendar year *after 1946*," the annual ceiling was based upon "remuneration * * * *paid* to such individual during such calendar year." Social Security Act Amendments of 1946, ch. 951, § 414(a)(3), 60 Stat. 991 (emphasis added). The legislative reports for the 1946 Act plainly state that the annual wage ceiling for benefit computation purposes (and for FICA and FUTA tax purposes) was thereafter to be determined based upon the date of the wage payment and "without

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[14] The Court expressly held that Title II of the Social Security Act, ch. 531, 49 Stat. 622, and *not* Title II of the Social Security Act Amendments of 1939, ch. 666, 53 Stat. 1362 (42 U.S.C. 401 *et seq.*), effective January 1, 1940, governed the benefit issues before it. 370 U.S. at 360.

regard to the year in which the employment occurred." S. Rep. No. 1862, *supra*, at 35; H.R. Rep. No. 2447, *supra*, at 35. See also page 18, *supra*. The statutory scheme considered in *Nierotko* thus obviously differed in this precise critical respect from the statutory provisions that have been in effect since 1946—the provisions that are involved in this case.[15]

2. Moreover, as the Sixth Circuit acknowledged in the *Bowman* case, the decision in *Nierotko* "is factually distinguishable from the present case" because it "involved back wages in the benefits context as opposed to the taxation context." 824 F.2d at 530; see also *Mazur* v. *Commissioner*, 986 F. Supp. 752, 755-756 (W.D.N.Y. 1997). The considerations relevant for benefit purposes are not necessarily the same as those for tax purposes. As this Court observed in *Flemming* v. *Nestor*, 363 U.S. 603, 609 (1960), "eligibility for benefits, and the amount of such benefits, do not in any true sense depend on contribution to the program through the

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[15] In a program policy statement, the Social Security Administration (SSA) has indicated that, for benefit computation purposes, it will continue to apply the *Nierotko* rule to one particular type of back wages—"back pay under a statute." SSA, Dep't of Health & Human Servs., SSR 83-7, 1981-1991 Soc. Sec. Rep. Ser. 18 (1983); see also 20 C.F.R. 404.1242(b). This policy statement applies only for benefit computation purposes; it does not apply for tax purposes. SSA, Dep't of Health & Human Servs., *Reporting Back Pay and Special Wage Payments to the Soc. Sec. Admin.*, Pub. No. 957 (Sept. 1997), at 1 ("The Social Security Administration (SSA) has special rules for back pay * * * for social security coverage and benefit purposes only."). Indeed, the SSA has noted that, under the rule that applies for tax purposes under the Social Security Act, "employers are liable for Federal Insurance Contributions Act tax payments on back pay on the basis of when the payment is made * * *." SSR 83-7, *supra*, at 19. Accord, Pub. No. 957, *supra*, at 2.

payment of taxes, but rather on the earnings record of the primary beneficiary." See also *Walker* v. *United States*, 202 F.3d 1290, 1293 (10th Cir. 2000) ("The Social Security Administration is a different agency, implementing a different statutory scheme."); note 15, *supra*. In determining an employee's eligibility for benefits, and the amount thereof, an allocation of an award of back wages to the periods of employment to which such back wages relate may be consistent with the policy of providing security to employees in retirement. Absent such an allocation, an employee may not obtain credit for a sufficient number of quarters to allow him to collect benefits and the amount of benefits awarded may similarly be affected.

No similar policy considerations are at stake in the tax context. Indeed, taxing back wages in the year actually paid does not routinely result in additional FICA and FUTA tax liability, even though it appears to do so in this particular case. To the contrary, in the common situation in which, during the year of payment (as opposed to the year to which such back wages could be attributed), the employee had already reached the maximum wage limit, *less* tax would be owed when the back wages are taxed in the year paid. As one commentator has pointed out, "[t]he *Bowman* case will seldom provide an advantageous result for current [taxpayers]." K. Gideon, *Lawsuits and Settlements* § 1101.4, at 262 (1995). Instead, it is "expensive for most taxpayers." *Id.* at 263 n.42.

Moreover, because of the complexities of restating tax liabilities for cash-basis taxpayers from the year of payment to former periods of time, the rule adopted in *Bowman* would "impose[] substantial administrative burdens" both on taxpayers and on the IRS. K. Gideon, *supra*, at 263 n.42. In particular, imposing these taxes

in the year the services were performed, rather than the year the wages were paid, would destroy symmetry between the collection of income taxes and FICA taxes on wages. Under the federal income tax (26 U.S.C. 1), "payments of compensation are income to a taxpayer on a cash basis in the year of receipt, as distinguished from the year in which the compensation is earned." *In re Freedomland, Inc.*, 480 F.2d 184 (2d Cir. 1973), aff'd *sub nom. Otte v. United States*, 419 U.S. 43 (1974). An employee who receives an award of back wages is, for purposes of the income tax, to include those wages in the year in which they are paid. The employer is also to withhold the resulting income taxes in that year. Under the rule adopted in the *Bowman* case, however, the employer would be required to withhold Social Security and Medicare taxes in the year the services were performed rather than in the year the wages were actually paid. The existence of two inconsistent withholding requirements for income and FICA taxes owed on the same wages would obviously create "difficulties and confusion" for "employers and administrative authorities alike." S. Rep. No. 734 , *supra*, at 76; H.R. Rep. No. 728, *supra*, at 62. It was expressly to "relieve" such "difficulties and confusion" that Congress amended these statutes in 1939 to place the FUTA and FICA taxes "on the 'wages paid' basis." S. Rep. No. 734, *supra*, at 75; H.R. Rep. No. 728, *supra*, at 63.[16] See pages 18, 23, *supra*.

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[16] The Internal Revenue Code contemplates that there will be some common administration of the income tax and the employment tax. For example, if an employee receives wages from more than one employer, the wages on which the employee pays FICA taxes through withholding by his employers may exceed the contribution and benefit base for a particular year (*i.e.*, the annual wage ceiling). Under 26 U.S.C. 6413(c)(1), the employee would

3. The suggestion in *Bowman* that the rule applied in *Nierotko* for benefit purposes under the *pre*-1946 statutory scheme governs this *post*-1946 tax case is contradicted by this Court's decision in *Otte* v. *United States*, 419 U.S. 43 (1974), aff'g *In re Freedomland, Inc.*, 480 F.2d 184 (2d Cir. 1973). In *Otte*, former employees of a bankrupt corporation filed wage claims for services performed prior to the filing of the bankruptcy petition. The district court held that the bankruptcy trustee was required to withhold federal income and employment taxes with respect to such claims. 419 U.S. at 46. The district court also held that the government was not required to file a proof of claim to recover the withheld taxes and that the government claim should be given fourth priority. *Id.* at 46-47. The court of appeals affirmed these holdings and rejected the trustee's assertion that requiring the trustee to withhold taxes would create an administrative "parade of horribles." 480 F.2d at 188. The court of appeals pointed out that most wage earners are on a cash basis and report their income taxes when their wages are received and that the "[w]ithholding of social security taxes is also done 'by deducting the amount of the tax from the wages *as and when paid*.'" *Id.* at 189 n.8 (quoting 26 U.S.C. 3102(a)). The court further noted that "[t]he taxes are by law calculable only when the wage claims are paid and not until then." *Id.* at 190. The court of appeals thus recognized that back pay is taken into account for FICA tax purposes in the year

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ordinarily receive a credit or refund of the tax to the extent that the tax exceeds the tax computed on the amount of a single annual wage ceiling. This credit or refund, however, is "subject to the provisions of section 31(b)." 26 U.S.C. 6413(c)(1). And, under 26 U.S.C. 31(b), the Secretary of the Treasury is authorized to apply an employment tax credit against the employee's income tax.

the payment is received, rather than the year for which the payment was owed.

This Court affirmed. 419 U.S. at 58. The Court first concluded that, although "the payments to the wage claimants who filed in this case [were] * * * made after the employment relationship terminated," they were still "wages" for purposes of income tax withholding and that "the situation is the same with respect to FICA withholding." *Id.* at 49, 51. The Court then observed that "Section 3102(a) of the Internal Revenue Code, 26 U.S.C. § 3102(a), provides that the tax is to be collected by the employer by deducting 'from the wages as and when paid.'" 419 U.S. at 51. The Court therefore concluded that "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." *Ibid.* The Court stated that this conclusion was also supported by the longstanding regulations that "consistently have been to this effect." *Ibid.* The Court emphasized that the payments became subject to FICA tax when paid, rather than when earned, for "[l]iability for the taxes accrues only when the wage is paid." *Id.* at 55 (citing 26 U.S.C. 3402(a) and 3101(a)). The Court explained that "[t]he wages that are the subject of the wage claims, although earned before bankruptcy, were not paid prior to bankruptcy. Freedomland [the debtor] had incurred no liability for the taxes. Liability came into being only during bankruptcy. The taxes do not partake, therefore, of the nature of debts of the bankrupt for which proofs of claim must be filed." 419 U.S. at 55. In *Otte*, the Court thus expressly concluded that, under the plain text of these statutes, FICA tax liability arises at the time that the back wages are paid, rather than at

the time the work to which the wage claim relates is performed.

4. The reasoning of the court of appeals in *Bowman* has been expressly rejected by the two courts of appeals that have considered it.[17] In *Hemelt* v. *United States*, 122 F.3d 204 (4th Cir. 1997), the taxpayers had received a payment in settlement of a class action suit brought under Section 502 of the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 891. The ERISA suit had alleged that the taxpayers' employer had improperly fired them to prevent them from qualifying for pension benefits. The taxpayers contended that the settlement payment did not represent "wages" subject to the FICA tax and further contended, relying on the Sixth Circuit's decision in *Bowman* (Appellant's Br. 46), that, even if the payment constituted "wages," it must be allocated to the years the wages would have been earned (but for the improper termination) instead of to the year the payment was received. 122 F.3d at 210. The Fourth Circuit first concluded that the settlement payment represented back pay for a wrongful termination of employment and

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[17] In *Johnston* v. *Harris County Flood Control District*, 869 F.2d 1565 (1989), the Fifth Circuit cited *Bowman* for the proposition that "[a]t least for purposes of FICA (Social Security) taxes, a plaintiff receiving a back pay award is liable for the taxes that would have accrued in the year the wages were due." *Id.* at 1580. The *Johnston* case, however, was not a tax case. The question whether the award would be subject to tax was relevant in that case *only* for the purpose of determining the proper amount of such an award. *Ibid.* For that purpose, the *timing* of the tax was not material. Instead, what was material was simply whether the backpay award would be taxable or "tax-free"—for only an "award that accounts for the plaintiff's tax liability accurately reflects the amount that the plaintiff actually lost." *Ibid.*

therefore constituted "wages" for purposes of the FICA tax. *Id.* at 209-210. The court then held that the taxpayer's reliance on the *Bowman* decision was "meritless." *Id.* at 210. Without discussing the *Bowman* opinion directly, the court rejected the reasoning of that decision because "[i]t is clear under the Treasury Regulations that 'wages' are to be taxed for FICA purposes in the year in which they are received." *Ibid.* (citing 26 C.F.R. 31.3121(a)- 2(a)).[18]

In *Walker* v. *United States*, 202 F.3d 1290 (2000), the Tenth Circuit has also rejected the analysis and conclusion of the *Bowman* decision. In that case, in the years 1992 through 1995, a lawyer received a portion of a contingency fee payment owed in connection with an antitrust lawsuit that had been filed in 1972 and settled in 1975. The lawyer paid Self-Employment Contributions Act (SECA) taxes imposed by 26 U.S.C. 1401 on the amounts received. He then brought a refund suit, claiming that the amounts received during the years 1992 through 1995 should be allocated to the years in which the services were performed (1971 through 1975). In urging that claim, he relied on the decision of this Court in *Nierotko* and the decision of the Sixth Circuit in *Bowman*. The Tenth Circuit found the decision in *Nierotko* "inapposite" and the decision in *Bowman* "unpersuasive," 202 F.3d at 1293. The Tenth Circuit, like the Fourth Circuit in *Hemelt*, relied significantly on the fact that the governing Treasury Regulations

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[18] The court of appeals noted in the *Hemelt* case that the taxpayers had provided no evidence of how the court should "allocate their awards among the years to which they [were] supposedly attributable" and that, as a consequence, the court "could not undertake such allocation even if [it] were allowed to do so." 122 F.3d at 210-211.

specify that wages are subject to tax when they are received, not when the services are rendered. *Id.* at 1292-1293.

5. The court of appeals thus erred in *Bowman* in failing to consider the plain language of the pertinent statutes, their legislative history, and the applicable Treasury Regulations—all of which establish that back wages are to be taken into account for FICA and FUTA tax purposes in the year actually paid, regardless of when the services were performed. The court of appeals should have been guided by this Court's decision in *Otte*, which applied the relevant statutory provisions, rather than this Court's decision in *Nierotko*, which applied statutory provisions that no longer exist and which have been amended by the provisions that are controlling in this case. See pages 31-33, *supra*.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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