No. 13-1098

In the Supreme Court of the United States

CENCAST SERVICES, L.P., ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES IN OPPOSITION

DONALD B. VERRILLI, JR.
Solicitor General
Counsel of Record
KATHRYN KENEALLY
Assistant Attorney General
FRANCESCA UGOLINI
PATRICK URDA
Attorneys

Department of Justice
Washington, D.C. 20530-0001
SupremeCtBriefs@usdoj.gov
(202) 514-2217

QUESTIONS PRESENTED

The Federal Insurance Contributions Act, 26 U.S.C. 3101 *et seq.*, and the Federal Unemployment Tax Act, 26 U.S.C. 3301 *et seq.*, define taxable "wages" as all remuneration for employment up to a statutory wage cap. The questions presented are as follows:

1. Whether, when an employee performs services for several common-law employers but is paid for this work by a single payroll service company, the statutory wage cap applies separately to the wages earned from each individual employer, or instead applies to the total amount paid by the payroll service company on behalf of all of the employers.

2. Whether the Court of Federal Claims abused its discretion by barring petitioners from raising, six years into the litigation, a new theory of relief that petitioners had not asserted in their refund claim filed with the Internal Revenue Service.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases—Continued: Page

Statutes, regulations and rules:

Statutes, regulations and rule—Continued: Page

Miscellaneous:

In the Supreme Court of the United States

No. 13-1098

CENCAST SERVICES, L.P., ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-31a) is reported at 729 F.3d 1352. The opinions of the Court of Federal Claims (Pet. App. 32a-95a, 96a-157a) are reported at 62 Fed. Cl. 159 and 94 Fed. Cl. 425, respectively.

JURISDICTION

The judgment of the court of appeals was entered on September 10, 2013. A petition for rehearing was denied on December 12, 2013 (Pet. App. 158a-159a). The petition for a writ of certiorari was filed on March 11, 2014. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Internal Revenue Code imposes employment taxes on wages paid by an employer to its em-

ployees. Those employment taxes include taxes imposed under the Federal Insurance Contributions Act (FICA), 26 U.S.C. 3101, *et seq.*, and a tax imposed on employers under the Federal Unemployment Tax Act (FUTA), 26 U.S.C. 3301, *et seq*. FICA and FUTA require an employer to pay a tax equal to a percentage of "wages * * * paid by him" "with respect to employment." 26 U.S.C. 3111(a), 3301.

FICA and FUTA both define the term "wages" as "all remuneration for employment," subject to an annual cap. 26 U.S.C. 3121(a)(1), 3306(b)(1). The FICA cap is reached when "remuneration * * * equal to the [applicable Social Security] contribution and benefit base * * * with respect to employment has been paid to an individual by an employer during the calendar year." 26 U.S.C. 3121(a)(1). The FUTA cap is reached when "remuneration * * * equal to $7,000 with respect to employment has been paid to an individual by an employer during [the] calendar year." 26 U.S.C. 3306(b)(1).

Both FICA and FUTA generally define employment as "any service, of whatever nature, performed * * * by an employee for the person employing him." 26 U.S.C. 3121(b), 3306(c). Those statutes also use a common-law definition of "employee": "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee." 26 U.S.C. 3121(d)(2), 3306(i). FUTA defines an "employer" as any person who, during a calendar year, either (1) has "paid wages of $1,500 or more," or (2) "on each of some 20 days" has employed at least one individual "in employment." 26 U.S.C. 3306(a)(1). FICA does not define the term "employer."

Common-law employers sometimes hire payroll services or similar companies to calculate and pay over wages to employees. To address arrangements in which third parties control the payment of wages, this Court and the courts of appeals have imported from the income-tax-withholding area certain principles addressing the responsibility to withhold and pay over taxes to the Internal Revenue Service (IRS). See *Otte* v. *United States*, 419 U.S. 43, 50-51 (1974); *Winstead* v. *United States*, 109 F.3d 989, 991-992 (4th Cir. 1997). In the income-tax-withholding context, if the common-law employer does not directly control the payment of wages, liability for withholding and paying over such taxes falls on the entity that exercises such control. 26 U.S.C. 3401(d)(1), 3402(a). That entity is sometimes referred to as the "statutory employer." In *Otte*, this Court applied the same rule to the payment of FICA taxes, 419 U.S. at 50-51, and it is now generally "accepted that *Otte* applies equally to the employer's FUTA and FICA tax obligations," Pet. App. 5a (citing cases).

2. a. This case involves wages earned by production workers in the movie industry. "[M]any production workers are now employed by several different production companies during the course of a year, rather than by a single large production studio." Pet. App. 3a. "Thus, in any given year, a given production worker might earn wages from several production companies." *Ibid.*

Petitioners are a group of related companies that provided administrative services to production companies in the movie industry. As part of those services, petitioners computed the amount of compensation owed to their clients' employees and prepared

checks (drawn on petitioners' accounts) for use in paying those employees. Joint Stipulation of Facts ¶ 20, at A1829-A1830 (Nov. 10, 2003) (Joint Stipulation of Facts). Petitioners delivered those checks to the production companies, which then handed them over to the employees. *Ibid.* The clients then "reimburse[d]" petitioners for the relevant payroll costs. *Ibid.* Petitioners also computed and paid employment taxes to the IRS with respect to the employment relationship between their clients and the employees. *Id.* ¶¶ 21-26, at A1830-A1831.

Petitioners categorized their clients' workers as employees for employment tax purposes, unless the workers provided services through a personal services corporation, in which case petitioners treated the worker as an independent contractor (and accordingly did not pay FICA or FUTA taxes for that worker). Pet. App. 99a. Petitioners paid FICA and FUTA taxes to the IRS with respect to wages paid to workers who were classified as employees. Joint Stipulation of Facts ¶¶ 21-26, at A1830-A1831.

The parties agree that petitioners "were not the common law employers of the production workers" for whom they paid FICA and FUTA taxes. Stipulation of Partial Compromise ¶ 1, at A2500 (May 14, 2008). Nonetheless, in calculating the employer's portion of the FICA and FUTA tax, petitioners "treated each employee as being in an 'employment' relationship with [petitioners] rather than with the production company." Pet. App. 5a. Thus, in computing the FICA and FUTA taxes owed on a particular worker's earnings, petitioners did not apply a separate wage cap to the earnings from each production company that had employed that worker during the year, but

rather applied a single wage cap to the worker's aggregate earnings from all common-law employers. Under that approach, petitioners ultimately paid to the IRS far less in FICA and FUTA taxes than their production-company clients would have paid if the clients had calculated and paid the taxes themselves.[1]

When collecting fees from each of their clients, petitioners "generally included, as a component of the bill, the FICA and FUTA taxes that would be due from the [client] if the [client] were treated as the employer for Federal employment tax purposes." Joint Stipulation of Facts ¶ 20, at A1829. As explained above, however, petitioners' method of calculating the FICA and FUTA taxes led them to pay far less to the IRS than those bills indicated. By aggregating the total wages paid to each employee by all of their clients, and by applying the wage caps only a single time for each worker, petitioners paid less in taxes and pocketed the savings for themselves. See Pet. App. 100a.

---

[1] By way of illustration, consider two employers paying FICA and FUTA taxes in 1996, when the FICA wage base was $62,700, the FUTA wage base was $7000, and the tax rate applicable to both taxes was 6.2%. If a single employee earned $62,700 from each employer—and if each employer itself directly paid the wages and taxes—each employer would separately apply the wage caps and pay $4321.40 in taxes for the employee (($62,700 x 6.2%) + ($7000 x 6.2%)). In those circumstances, the IRS would receive a total of $8642.80 with respect to that employee. But if the two employers instead hired petitioners to make the wage and tax payments, petitioners would apply the wage caps only once to the aggregate wages of $125,400 earned from both employers, thus paying the IRS only $4321.40 in taxes (($62,700 x 6.2%) + ($7000 x 6.2%)). See generally Pet. App. 6a (providing similar illustration).

b. In 1994, the IRS began an inquiry into petitioners' employment tax returns, focusing on whether petitioners had properly calculated and remitted FICA and FUTA taxes. Pet. App. 6a, 101a-102a. In response to an IRS document request, petitioners asserted that they "do[] not pay independent contractors and that has been [their] policy for many years." Information Doc. Req. No. 13, at A5529 (Oct. 1, 1992). Petitioners included with that response an inter-office memorandum outlining the risks of hiring independent contractors. *Id.* at A5531.

In 2001, the IRS assessed against petitioners deficiencies of approximately $43.7 million in FUTA taxes and $15.6 million in FICA taxes. Pet. App. 7a. That assessment was based on the IRS's conclusion, set forth in a 1997 Technical Advice Memorandum (TAM), that "FUTA and FICA taxes should be calculated as though each employee were in an employment relationship with each individual production company, rather than with [petitioners.]" *Id.* at 6a (citing IRS TAM-119980-97, http://www.irs.gov/pub/irs-wd/9918056.pdf). Petitioners made partial payments sufficient to file administrative claims for refund. *Id.* at 7a; see generally *University of Chi.* v. *United States*, 547 F.3d 773, 785 (7th Cir. 2008) (discussing procedure by which taxpayer may assert refund claims for divisible taxes).

The IRS disallowed petitioners' claims, and petitioners brought the instant refund suits in May 2002. Pet. App. 6a-7a. The government asserted counterclaims for the remaining, unpaid balances of the IRS's assessments. *Id.* at 7a.

3. a. The Court of Federal Claims (CFC) granted partial summary judgment to the government. The

court held that, in computing FICA and FUTA tax obligations with respect to a particular employee, the statutory wage caps must be applied separately for each common-law employer. Pet. App. 32a-95a. The court rejected petitioners' argument that references in FICA and FUTA to remuneration "paid" by an employer indicate that petitioners—as the entities that calculated the wages due and cut the checks—are the relevant employers for calculation of the wage cap. *Id.* at 49a-52a. The court explained that, although entities that pay wages are (under *Otte* and its progeny) "statutory employer[s]" for purposes of withholding and paying the taxes, the wages subject to tax must still be calculated separately for each common-law employer. *Id.* at 81a-85a.

b. After two years of unsuccessful settlement discussions, the CFC allowed the parties to file amended pleadings by February 23, 2007. Order A2221-A2222 (Jan. 23, 2007). The government amended its answers and counterclaims, Amended Answer and Counterclaim A2225-A2254 (Feb. 23, 2007), but petitioners did not. The parties later entered into a partial settlement resolving multiple issues. Stipulation of Partial Compromise A2500-A2501 (May 14, 2008); see also Order A2503 (June 23, 2008).

At an August 25, 2008, status conference, petitioners argued for the first time that some of the workers at issue were actually independent contractors, and that petitioners therefore were entitled to a credit for the FICA and FUTA taxes paid with respect to those workers as an offset to the IRS assessments. Status Conference Tr. (Tr.) 6, at A2531. Petitioners first reduced that theory to writing in a joint status report filed on March 5, 2009. At a conference the next day,

the government protested that "there [are] some legal barriers to the position that apparently the [petitioners] are now taking." Tr. 37, at A2591 (Mar. 6, 2009). The government continued to object to the introduction of this new issue and requested that discovery not proceed until after resolution of its legal challenges. See, *e.g.*, Tr. 27, at A2716 (Apr. 17, 2009); Tr. 13, at A3037 (July 13, 2009). The CFC denied the government's request. Order A4287 (Sept. 23, 2009).

c. The government subsequently filed a motion in limine to exclude the independent-contractor issue, which the CFC granted. Pet. App. 96a-157a. The court ruled that the new issue was barred by the substantial-variance doctrine, which prevents a litigant in a refund suit from arguing issues not raised in its administrative refund claim, because the IRS "was not asked to and did not investigate whether any production workers were actually independent contractors." *Id.* at 119a. The court rejected petitioners' contention that they were entitled to assert the theory by styling their claim as an offset. The court concluded that the government's counterclaims, which merely sought the remainder of the unpaid tax assessments, raised no new issues. *Id.* at 121a-127a.

The CFC further held that, even if the theory had not been barred by the substantial-variance doctrine, the court would not consider that theory because of petitioners' undue delay in raising it and the resulting prejudice to the government. Pet. App. 138a-141a. The court subsequently entered an agreed-upon final judgment setting the amounts of petitioners' tax liabilities consistent with the court's holdings. Judgment A1 (Sept. 4, 2012).

4. The court of appeals affirmed. Pet. App. 1a-31a.

a. Petitioners had argued that, when a statutory employer controls the payment of wages, the wage cap is calculated based on the total amount paid by the statutory employer. The court of appeals assumed, without deciding, "that when a single entity controls the payment of wages (i.e., it formally makes the tax payments), that entity is the 'employer' who has 'paid' the 'wages' or 'remuneration' under FUTA." Pet. App. 11a. The court stated, however, that "it does not follow that the caps are to be computed as though the 'employment' of the employees was by [petitioners] and not by the multiple common law employers here (the production companies)." *Ibid.* (quoting 26 U.S.C. 3306(b)(1)). Focusing on the language of the FUTA wage cap, 26 U.S.C. 3306(b)(1), the court observed that "the wage cap is 'equal to $7,000 [paid] with respect to employment.' It is therefore 'employment,' not 'employer,' that is the relevant term for the wage cap amount." Pet. App. 12a.

The court of appeals further held that "'employment' under [Section] 3306(b)(1) must refer to the common law employment relationship." Pet. App. 12a. The court reviewed the statutory definitions of "employment" and "employee" and stated that "[t]hese references in the FUTA statute * * * consistently refer to employment in the common law sense, and the wage cap provision must therefore be calculated with respect to the employee's various common law employments during the calendar year." *Ibid.*

The court of appeals noted that its decision was consistent with the Ninth Circuit's holding in *Blue Lake Rancheria* v. *United States*, 653 F.3d 1119 (2011), that a FUTA exemption for services performed

in the employ of an Indian tribe did not apply where the tribe controlled the payment of wages but was not the common-law employer. The court stated that "[t]his case, like *Blue Lake*, involves provisions * * * that are designed to exempt certain wages from tax, and we agree with *Blue Lake* that only common law employment is relevant to such exemptions." Pet. App. 13a.

The court of appeals reached the same conclusion regarding the FICA wage cap. The court observed that "the wage cap provision of FICA [*i.e.*, 26 U.S.C. 3121(a)(1)], defining the 'wages' to be taxed under FICA, has the identical structure to the corresponding FUTA provision." Pet. App. 15a. The court held that, as with FUTA, "the computation of the [FICA] wage cap is made with respect to common law 'employment.'" *Ibid.*

The court of appeals further observed that, under petitioners' interpretation, "the statutory employer's tax liability is less than the aggregate liability of the production companies if they had paid the employees directly." Pet. App. 14a. The court found "[n]othing" in the Internal Revenue Code to "suggest[ ] that Congress intended that common law employers be given the option to choose a different wage cap (and effectively reduce the amount of their tax liability) depending on whether they chose to administer payroll themselves or to delegate that responsibility to another entity." *Ibid.* Rather, the court stated, "Congress intended the wage cap calculation to be the same whether the Service Company or the production company paid the wages to the employees." *Ibid.*

b. The court of appeals also upheld the CFC's refusal to allow petitioners to raise the independent-

contractor issue. Pet. App. 19a-22a. The court focused on the CFC's authority under Court of Federal Claims Rule 15(a) to deny leave to amend pleadings where "such amendments * * * result in undue delay or prejudice." Pet. App. 19a. The court pointed out that petitioners' original complaint did not reference the issue and that the government would be particularly prejudiced, in light of the parties' extensive efforts to "define and narrow the relevant issues." *Id.* at 20a. The court further noted that this "evident prejudice" to the government was underscored by the fact that petitioners, "without explanation, failed to raise the issue in a refund claim or pleading for over fifteen years." *Id.* at 21a-22a.

The court of appeals also rejected petitioners' argument that "its original 2002 refund claim was sufficient to preserve the independent contractor theory," and it agreed with the CFC that the late introduction of the theory was barred by the doctrine of substantial variance. Pet. App. 26a-27a. The court further explained that the doctrine of setoff generally does not apply in the divisible tax setting, where the government's counterclaim simply "places the entire balance of assessed tax in issue." *Id.* at 27a. The court held that, in that situation, the right to assert a setoff exists only when the government introduces a new issue that petitioners could not have anticipated in their original refund claim. *Id.* at 27a-28a.

ARGUMENT

The Federal Circuit's decision is correct and does not conflict with any decision of this Court or another court of appeals. Further review is not warranted.

1. Petitioners argue that, for each individual whose FICA and FUTA taxes are at issue in this case, the

statutory wage caps must be applied only once, to the total amount paid by petitioners to that employee. The court of appeals correctly rejected that contention.

a. As petitioners acknowledged below, the proper calculation of the FICA and FUTA wage caps in these circumstances presents "an issue of first impression in the federal courts." Pet. App. 166a. The court of appeals' resolution of that issue in the government's favor is the only appellate decision directly on point. Petitioners assert that the issue is "unlikely to arise in future litigation" because "[t]he risk of severe tax penalties is simply too great for employers to chance noncompliance with the Federal Circuit's [decision]," and because 28 U.S.C. 2201 precludes declaratory judgment actions with respect to federal taxes. Pet. 3. But any employer who wishes to press petitioners' arguments in another circuit can do so by paying a divisible portion of the employment taxes assessed, filing an administrative refund claim with the IRS, and then bringing suit in district court. See 26 U.S.C. 7422; *University of Chi. v. United States*, 547 F.3d 773, 785 (7th Cir. 2008).

b. The court of appeals correctly held (Pet. App. 10a) that the FICA and FUTA wage caps must be calculated by reference to the remuneration earned from each common-law employer (or employers), rather than by reference to the total amount paid to a given employee by a payroll service company. The text, structure, and purpose of the relevant statutory provisions support that interpretation, as do the pertinent IRS regulations and this Court's analysis in *Otte* v. *United States*, 419 U.S. 43 (1994).

FICA and FUTA impose excise taxes on "every" employer "with respect to having individuals in his

employ." 26 U.S.C. 3111, 3301. That language makes clear that *all* employers are subject to the tax with respect to their employees. The phrase "having individuals in his employ" clearly refers to a common-law employment relationship. See 26 U.S.C. 3121(d)(2) (defining "employee" as "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee"); 26 U.S.C. 3306(i) (adopting definition of "employee" in Section 3121(d)(2)).

FICA and FUTA taxes are imposed on "wages" paid with respect to "employment." 26 U.S.C. 3121(a)(1), 3306(b)(1). The statutes define "employment" as "any service, of whatever nature, performed * * * by an employee for a person employing him." 26 U.S.C. 3121(b), 3306(c). Those provisions confirm that the FICA and FUTA taxes target the wages earned in the course of every common-law employment relationship. The term "employment" does not refer to the relationship between an employee and a payroll services company hired by his common-law employer because the employee does not "perform[]" "any service" for such a company. *Ibid.*

FICA defines "wages" as "all remuneration for employment," but only up to a specified cap. 26 U.S.C. 3121(a)(1). In pertinent part, the definition of "wages" excludes "that part of the remuneration which, after remuneration * * * equal to the contribution and benefit base * * * with respect to employment has been paid to an individual by an employer during the calendar year * * * , is paid to such individual by such employer." *Ibid.* FUTA defines "wages" in a similar fashion, albeit with a lower statutory cap. It notes that "wages" are "all remuneration

for employment," up to a cap "equal to $7,000 with respect to employment [that] has been paid to an individual by an employer during any calendar year." 26 U.S.C. 3306(b)(1). In context, the term "employer" in these wage-cap provisions refers to the common-law employer, and not to any other employer (such as a payroll service company) who may control the payment of wages. Only the common-law employer is part of the "employment" relationship, for which the wages at issue are being paid, that is the overwhelming focus of the relevant provisions.

IRS regulations also support treating each common-law employer as the relevant employer when calculating the wage caps. Those regulations prohibit employers from aggregating the remuneration received from multiple employers during the year for purposes of determining whether the FICA and FUTA wage caps have been met. The FICA regulation states that, when an employee receives wages from more than one employer, the wage cap "does not apply to the aggregate remuneration received from all of such employers, but instead applies to the remuneration received * * * *from each employer* with respect to employment." 26 C.F.R. 31.3121(a)(1)-1(a)(3) (emphasis added). The FUTA regulation is virtually identical. See 26 C.F.R. 31.3306(b)(1)-1(a)(3). Both regulations are entitled to judicial deference. See *Mayo Found. for Med. Educ. & Research* v. *United States*, 131 S.Ct. 704, 711-714 (2011); Pet. App. 13a n.4.

Petitioners were hired by film production companies to perform various payroll services with respect to the production companies' common-law employees. The IRS regulations required petitioner, in calculating the FICA and FUTA taxes for each employee, to

apply the wage caps set forth in Sections 3121(a)(1) and 3306(b)(1) separately to each production company for which the employee performed services, rather than applying the caps to the aggregate wages received by that worker. Petitioners' failure to apply the prescribed methodology resulted in an underpayment of approximately $59 million. Pet. App. 7a.[2]

c. Petitioners contend (Pet. 16-21) that the wage caps must be calculated with respect to the employer that controls the payment of wages to employees, rather than with respect to the common-law employers. Their principal argument is that FUTA defines an "employer" to include a person "who paid wages of $1,500 or more" during any calendar quarter. 26 U.S.C. 3306(a)(1)(A). Petitioners contend that (1) they qualify as "employer[s]" under that statutory definition, and (2) the definition applies to the wage-cap

---

[2] Although petitioners are not the relevant "employer" for purposes of the wage cap provisions, 26 U.S.C. 3121(a)(1), 3306(b)(1), they are liable for FICA and FUTA taxes under this Court's analysis in *Otte*. The Court in *Otte* made clear that 26 U.S.C. 3401(d)(1), which defines the term "employer" for purposes of income-tax withholding, also applies to FICA withholding. 419 U.S. at 51; see Pet. App. 5a (citing cases also applying *Otte*'s holding to FUTA withholding). Section 3401(d)(1) provides that, if a common-law employer "does not have control of the payment of the wages," then the relevant "employer" for purposes of the withholding requirement is "the person having control of the payment of such wages." 26 U.S.C. 3401(d)(1). As this Court explained, "[Section 3401(d)(1)] obviously was intended to place responsibility for withholding at the point of control [over the taxes]." *Otte*, 419 U.S. at 50. Here, petitioners were responsible for calculating the wages owed by their clients and for preparing the checks, and they substantially controlled such payments for purposes of Section 3401(d)(1). Petitioners do not dispute that they were obligated to pay the FICA and FUTA taxes at issue here.

provisions in both FUTA and FICA. Neither of those arguments is correct.

FUTA's definition of "employer" to include those "who paid wages of $1,500 or more" in any quarter, 26 U.S.C. 3306(a)(1), was not intended to encompass payroll service companies that pay wages to workers employed by their clients. Rather, as the CFC explained, it was intended to impose FUTA liability on any common-law employer with a payroll of a certain amount. Pet. App. 79a-81a (discussing legislative history in detail); H.R. Rep. No. 612, 91st Cong., 1st Sess. 9 (1969) (explaining that Section 3306(a)(1)'s payroll-based definition of employer "is intended to insure coverage of significant operations conducted in fewer than 20 weeks in any one calendar year"). Section 3306(a)(1)(A)'s reference to employers "who paid wages of $1,500 or more" therefore encompasses employers who paid such wages *to their own employees*.

Petitioners are also wrong to assume that FUTA's definition of "employer" applies to FICA's wage-cap provision, 26 U.S.C. 3121(a)(1). By its own terms, the FUTA definition applies only "[f]or purposes of this chapter"—*i.e.*, Chapter 23 of Title 26. 26 U.S.C. 3306(a). FICA is codified in Chapter 21 of Title 26. Nothing in FICA casts doubt on the commonsense notion that the common-law employer is the relevant "employer" for purposes of Section 3121(a). Petitioners' contrary approach would violate Congress's intent and enable common-law employers to avoid taxes by strategically engaging payroll service companies. Pet. App. 17a-18a.[3]

---

[3] Petitioner quotes FUTA's definition of "employer" from Section 3306(a)(1) and asserts that "courts have treated the meaning of 'employer' identically for purposes of FUTA and FICA." Pet. 3.

Petitioners also argue that "'[t]he same words in the same statute should be interpreted in the same manner,'" and that petitioners cannot be treated as "employer[s]" when assessing liability for FICA and FUTA taxes but not when calculating the wages subject to tax under Sections 3121(a) and 3306(b)(1). Pet. 17-19 (quoting *Commissioner* v. *Lundy*, 516 U.S. 235, 250 (1996)). The general presumption of consistent usage, however, "is particularly defeasible by context." Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 171 (2012); see *Cherokee Nation* v. *Georgia*, 30 U.S. (5 Pet.) 1, 19 (1831) (Marshall, C.J.) (declaring "undoubtedly true" that "the same words have not necessarily the same meaning attached to them when found in different parts of the same instrument" because "their meaning is controlled by context"). This Court has recognized that the phrase "wages paid" in Sections 3111(a) and 3301 does not necessarily mean the same thing as "wages" that have been "paid" for purposes of calculating Social Security benefits under the provision now codified at 42 U.S.C. 413(a)(2). *United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200, 212-213 (2001). The Court explained that the presumption that "identical words used in different parts of the same act are intended to have the same meaning" is

---

Neither of the decisions that petitioner cites for this proposition applied Section 3306(a)(1)'s definition of "employer" to FICA. Rather, those decisions applied the definition of "employer" set forth in Section 3401(d)(1) (which governs income-tax withholding) to FICA and FUTA, and only for purposes of determining which entity is responsible for withholding those taxes. *Blue Lake Rancheria* v. *United States*, 653 F.3d 1112, 1117 (9th Cir. 2011); *Winstead* v. *United States*, 109 F.3d 989, 991 (4th Cir. 1997).

"not rigid," and that the meaning "may vary to meet the purposes of the law." *Id.* at 213 (citation omitted).

Here, the context makes it especially clear that different definitions of "employer" apply with respect to (1) imposition of liability for underpayment of taxes, and (2) calculation of the wages subject to tax. As explained above, petitioners are liable because, under *Otte*, they qualify as "employer[s]" under the definition set forth in 26 U.S.C. 3401(d)(1).[4] That definition expressly declares that it does *not* apply to the calculation of taxable "wages" under Section 3401(a). 26 U.S.C. 3401(d)(1). Rather, Section 3401(a) treats the common-law employer as the relevant employer.

Finally, petitioners assert (Pet. 19) that the court of appeals' decision "cannot be reconciled with the universally held understanding that *employees* are taxed only once up to the annual FICA wage limit." Petitioners are mistaken.

An individual employee may have excess FICA taxes withheld if, for example, she earns income up to the wage cap from one employer and then changes jobs during the year and earns additional income from her new employer. To comply with the tax laws, both employers must withhold and pay to the IRS the employee's share of the FICA tax on the wages they paid her. Section 6413(c) provides for a "[s]pecial refund[]" of the employee's share of any taxes paid on any wages exceeding the cap. 26 U.S.C. 6413(c). Far from

---

[4] Petitioners repeatedly imply (Pet. i, 17-19) that their own liability for the FICA and FUTA taxes flows from 26 U.S.C. 3111 (FICA) and 3301 (FUTA), respectively. The Court in *Otte* did not rely on these provisions, however, but rather relied on 26 U.S.C. 3401(d)(1) to impose FICA liability on a third party responsible for making wage payments. 419 U.S. at 50-51.

supporting petitioners' argument, that refund provision simply confirms that every employer is required to calculate the FICA wage cap based on its own common-law employment relationship with the employee. And Section 6413(c) has no effect on the common-law employer's own share of FICA tax on wages paid to its employee.

d. Petitioners and their amicus also argue that the court of appeals' decision imposes unworkable administrative burdens on payroll services companies (Pet. 11-14) and that it harms workers (Pet. 14-16; Amicus Br. 11-14). Those contentions are unsound.

Petitioners' reference (Pet. 13) to the purported difficulties in "track[ing] wages earned by each employee for work performed for each common-law employer during a year" is at odds with the joint stipulation entered below. Petitioners stipulated that they "generally included, as a component of the bill [to their clients], the FICA and FUTA taxes that would be due from the [client] if the [client] were treated as the employer for Federal employment tax purposes." Joint Stipulation of Facts ¶ 20, at A1829 (Nov. 10, 2003). Petitioners also contend (Pet. 14) that "IRS forms presently do not accommodate such reporting, and we are informed that IRS computer systems do not accept such input." Although the IRS forms for reporting employment tax do not include explicit instructions for statutory employers under 26 U.S.C. 3401, the forms do not preclude a statutory employer from computing and paying the correct employment taxes.

Petitioners and their amicus also argue (Pet. 14-16; Amicus Br. 11-14) that the court of appeals' decision will hurt workers because employers might reclassify

employees as independent contractors to avoid their proper tax liability. But whether a worker qualifies as an employee or independent contractor turns on traditional common-law standards, see Rev. Rul. 87-41, 1987-1 C.B. 296 (1987), and nothing in this case alters those standards.

2. Petitioners challenge (Pet. 21-30) the court of appeals' holding that they cannot belatedly advance their independent-contractor argument under the common-law doctrine of recoupment. The court of appeals limited its holding to the narrow circumstances present here—*i.e.*, when "the government files a counterclaim that places the entire balance of assessed tax in issue," but without "rais[ing] a new issue" that the plaintiff "could not have anticipated" when it filed its original refund claim. Pet. App. 27a (internal quotation omitted). The courts below also excluded the independent-contractor theory on an alternative basis unrelated to recoupment. In any event, there is no split of authority on the availability of recoupment in these circumstances, and the court of appeals' holding was correct. Further review is not warranted.

a. In 2008, petitioners sought to argue—for the first time in the case—that they had overpaid the FICA and FUTA taxes by submitting payments for workers who were independent contractors rather than "employees." See pp. 7-8, *supra*. The CFC refused to consider that argument for two independent reasons. First, the court held that the independent-contractor argument substantially varied from the challenges raised in petitioners' administrative refund claim, and that petitioners could not raise the issue as a "setoff" to the government's counterclaims for un-

paid taxes under a recoupment theory. Pet. App. 121a-127a. Second, the court refused to allow the independent-contractor claim to proceed because petitioners had unduly delayed in raising that theory within the suit itself, causing prejudice to the government. *Id.* at 138a-141a. The court of appeals affirmed on both grounds. *Id.* at 18a-28a. As to the second ground, the court emphasized the CFC's authority under Court of Federal Claims Rule 15(a) to deny leave to amend pleadings where "such amendments * * * result in undue delay or prejudice." *Id.* at 19a.

Although petitioners acknowledge (Pet. 10) that the court of appeals invoked Rule 15(a) as an alternative ground for rejecting their independent-contractor theory, they do not seek review of the Rule 15(a) issue itself. Thus even if petitioners prevail on their recoupment theory, they will still be barred from injecting their independent-contractor theory into this case on remand. This Court should not grant certiorari to consider an issue that will ultimately have no effect on the outcome of this case.[5]

b. Petitioners argue (Pet. 24-26) that the decision below conflicts with the Second Circuit's decision in *United States* v. *Forma*, 42 F.3d 759 (1994). The court

---

[5] Despite failing to raise the Rule 15(a) issue as one of their questions presented, petitioners assert (Pet. 28-30) that the government forfeited any objection based on undue delay and prejudice by acquiescing in discovery. The court of appeals correctly held that the government did not acquiesce in discovery. Pet. App. 21a & n.7. Rather, the government moved to stay any such discovery and participated only after the CFC denied that motion. *Ibid.*; see Gov't Resp. to Pet. for Reh'g 6-8; Gov't C.A. Br. 67-70. Petitioners' highly factbound disagreement with the court of appeals' analysis of the proceedings below (Pet. 29-30) reflects a misreading of the record.

in *Forma* explained that, when the government brings an affirmative suit to reduce an assessment to judgment, it thereby waives its sovereign immunity with respect to counterclaims by the taxpayer. *Id.* at at 764-765. The court concluded that the taxpayer could assert, as a "recoupment counter-claim" to reduce the government's recovery, challenges that would have been jurisdictionally barred if the taxpayer had brought an affirmative action. *Ibid.*

The court below limited its recoupment holding to the narrow situation presented in this case, in which (1) petitioners filed an affirmative refund claim, (2) the government "file[d] a counterclaim that place[d] the entire balance of assessed tax in issue," and (3) the issues raised by the government's counterclaim could have been anticipated in petitioners' refund claim and asserted as grounds for that claim. Pet. App. 27a. By contrast, *Forma* involved litigation that the government had initiated in order to reduce a tax assessment to judgment. The *Forma* court did not address either (1) defenses to government counterclaims or (2) a situation in which the taxpayer failed to raise his arguments in the refund claim giving rise to the suit.

c. The court of appeals correctly held that the doctrine of substantial variance bars consideration of the independent-contractor issue in this case.[6]

To maintain a suit for the refund of any tax, a taxpayer must first file a claim for refund with the IRS. See 26 U.S.C. 7422(a); 26 C.F.R. 301.6402-2(b)(1).

---

[6] Contrary to petitioners' suggestions (Pet. i, 26, 28) neither the court of appeals nor the government has conceded that petitioners overpaid taxes due to the misclassification of independent contractors.

"Courts have long interpreted [26 U.S.C.] 7422(a) and [26 C.F.R.] 301.6402-2(b)(1) as stating a 'substantial variance' rule which bars a taxpayer from presenting claims in a tax refund suit that 'substantially vary' the legal theories and factual bases set forth in the tax refund claim presented to the IRS." *Lockheed Martin Corp.* v. *United States*, 210 F.3d 1366, 1371 (Fed. Cir. 2000). Section 7422(a)'s exhaustion requirement operates as a limit on the government's waiver of sovereign immunity from suit. *Forma*, 42 F.3d at 763.

Petitioners contend (Pet. 27) that "common-law recoupment is always available as a defense to prevent the government from collecting money to which it is not entitled." As applied in the tax context to counterclaims or defenses raised against the government, recoupment is an "exception" to the general rule of sovereign immunity, as it enables taxpayers to raise arguments that might otherwise be barred by Section 7422(a). *Forma*, 42 F.3d at 765. Recoupment "does not permit any affirmative recovery against the United States," but simply allows the taxpayer to reduce or defeat the government's affirmative claims. *Ibid.* Courts typically justify the recoupment exception to sovereign immunity on the ground that the government has waived its immunity by bringing its affirmative claims against the taxpayer. *Ibid.* (citing cases).

This case, by contrast, was initiated by *petitioners*, who sought refunds of a divisible tax. A divisible tax "is one that represents the aggregate of taxes due on multiple transactions," such as excise taxes and employment taxes. See *Rocovich* v. *United States*, 933 F.2d 991, 995 (Fed. Cir. 1991). This Court has excepted divisible-tax refund suits from the normal rule requiring full payment of an assessment before initiat-

ing a refund action challenging that assessment. *Flora* v. *United States*, 362 U.S. 145, 171 n.37, 175 n.38 (1960). The Court has thus allowed employers to seek full resolution of an employment-tax dispute by paying the assessed tax with respect to only one of the individual transactions, waiting for the IRS to deny its refund claim with respect to that transaction, filing a refund action, and then litigating the full dispute.

As various courts of appeals have emphasized, the divisibility rule benefits taxpayers by allowing them to challenge the merits of a tax liability determination without first paying the entire amount that the IRS claims is due.[7] The purpose of the procedure is essentially to allow taxpayers to initiate a "representative" suit. Pet. App. 25a. Indeed, Congress has "recognized the representative nature of a divisible refund suit" by "foreclosing IRS levies 'with respect to any unpaid divisible tax during the pendency of any [previously-filed refund] proceeding brought . . . in a

---

[7] See, *e.g.*, *University of Chi.*, 547 F.3d at 785 (noting that, when tax is divisible, "the taxpayer may pay the full amount on one transaction, sue for a refund for that transaction, and have the outcome of this suit determine his liability for all the other, similar transactions"); *Ruth* v. *United States*, 823 F.2d 1091, 1093 (7th Cir. 1987) (noting that divisible-tax rule allows taxpayer "to challenge an assessment in the district court merely by paying a portion of the assessment and then seeking a refund"); *Boynton* v. *United States*, 566 F.2d 50, 52 (9th Cir. 1977) (noting that divisible-tax rule is designed as a means of "'settling the question of the right of the government to have made [the entire tax] assessment [against the taxpayer]'") (quoting *Steele* v. *United States*, 280 F.2d 89, 91 (8th Cir. 1960)); *Lucia* v. *United States*, 474 F.2d 565, 576 (5th Cir. 1973) (en banc) (noting that purpose of divisible refund claim is to "test the validity of the entire assessment").

proper Federal trial court.'" *Ibid.* (citing 26 U.S.C. 6331(i)(1)(A)).

A taxpayer bringing a refund lawsuit on a divisible tax is deliberately putting the merits of the entire tax liability at issue. Section 7422(a) and 26 C.F.R. 301.6402-2 require a taxpayer to fully exhaust his claims administratively before filing suit against the government in court. Allowing taxpayers to raise new claims and theories in the guise of a recoupment defense would end-run the exhaustion requirement and allow the taxpayer to litigate his full tax liability unconstrained by the four corners of his refund claim. That approach would disserve the purposes of Section 7422(a), which was "designed both to prevent surprise and to give adequate notice to the Service * * * , thereby permitting an administrative investigation and determination." *Computervision Corp.* v. *United States*, 445 F.3d 1355, 1363 (Fed. Cir. 2006), cert. denied, 549 U.S. 1338 (2007) (internal citations omitted).

The court below avoided that outcome by barring petitioners from litigating an independent-contractor issue that they first raised in 2008, six years after filing their administrative refund claim. That decision appropriately respects the statutory and regulatory scheme and prevents taxpayers from abusing the taxpayer-friendly procedures that apply to refund claims for divisible taxes.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

DONALD B. VERRILLI, JR.
Solicitor General
KATHRYN KENEALLY
Assistant Attorney General
FRANCESCA UGOLINI
PATRICK URDA
Attorneys

MAY 2014