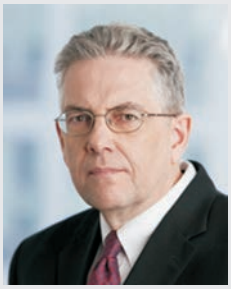
Quality Stores and the Status of Revenue Rulings

By Patrick J. Smith


Patrick J. Smith

Patrick J. Smith is a partner at Ivins, Phillips & Barker in Washington.

The issue in *Quality Stores* is whether the supplemental unemployment compensation benefits that are excluded from taxable wages for FICA purposes are determined by a series of IRS revenue rulings, as the government contends, or by the statutory definition of supplemental unemployment compensation benefits, as the taxpayer contends. The government does not explain how revenue rulings can provide the definitive legal answer. Nor does it even attempt to defend the correctness of the positions expressed in the rulings. The taxpayer's position is coherent and sensible, whereas the government presents no supportable alternative. As a result, the taxpayer's position clearly must be preferred.

Table of Contents

I. Introduction

In *United States v. Quality Stores Inc.*,[1] the government and the taxpayer agree that some supplemental unemployment compensation benefits (SUBs) are excluded from taxable wages for purposes of FICA, even though those benefits are included in the recipient's taxable income and are subject to income tax withholding. The parties disagree, however, on which of those benefits are excluded for FICA purposes.

The government maintains that the only SUBs excluded from taxable wages for FICA purposes are those that satisfy the requirements imposed by a series of IRS revenue rulings issued between 1956 and 1990. The taxpayer contends that the FICA exclusion extends to any benefits that come within the statutory definition of SUBs in section 3402(o)(2)(A), which applies for income tax withholding purposes.

The benefits at issue in *Quality Stores* are severance payments made to employees in connection with the termination of the taxpayer's business operations. Importantly, the payments were in no way tied to state unemployment compensation benefits. A 1990 revenue ruling requires that connection for the payments to be excluded from taxable wages for FICA purposes. In contrast, the statutory definition of SUBs in section 3402(o)(2)(A) does not require that the benefits be tied to state unemployment compensation benefits.

The Sixth Circuit agreed with the taxpayer that the statutory definition controls for FICA purposes, even though the definition by its terms applies only for income tax withholding purposes. However, in a separate case involving a different taxpayer, *CSX Corp. v. United States*,[2] the Federal Circuit agreed with the government that the revenue rulings, rather than the statutory definition, control for FICA purposes. The government has filed a petition for certiorari asking the Supreme Court to review the Sixth Circuit's decision in *Quality Stores*. That petition likely will be granted in light of the circuit split and the Court's tendency to grant certiorari petitions filed by the government.

The appellate briefs and opinions in *Quality Stores* and *CSX* largely emphasize the taxpayers' position that the definition of SUBs in section 3402(o)(2)(A), which applies for purposes of federal income tax withholding, determines which benefits are excluded from taxable wages for FICA purposes. They give much less attention to the question of whether the government is correct that the only benefits excluded from FICA tax are those that satisfy the requirements of the revenue rulings.

[1]693 F.3d 605 (6th Cir. 2012), *petition for cert. filed* (U.S. May 31, 2013) (No. 12-1408).

[2]518 F.3d 1328 (Fed. Cir. 2008), *rev'g* 52 Fed. Cl. 208 (2002).

However, an evaluation of the taxpayer's position is only part of the picture and should not be the sole basis for deciding a case.

The court must also consider the merits of the government's position. In that regard, the government is clearly mistaken that a series of IRS revenue rulings can properly establish a controlling answer to the legal question of which SUBs are excluded from taxable wages for FICA purposes.[3]

It is notable that the government itself is equivocal in its position regarding the legal status of the revenue rulings. It contends that the taxpayer in *Quality Stores* cannot prevail because the benefits do not satisfy the requirements of the revenue rulings. However, the government declines to defend the requirements themselves; it says that the correctness of the revenue rulings is not at issue in the case.

Moreover, the government asserts that it is not claiming the revenue rulings are entitled to judicial deference. Yet, the government fails to explain how IRS documents that it acknowledges are not entitled to deference still could be determinative on the legal question of which SUBs are excluded from taxable wages for FICA purposes. And the petition for certiorari does not provide a satisfactory explanation of the basis for the government's position regarding the status of the revenue rulings.

When the issue in this case is evaluated based on considering the merits of both the government's position and the taxpayer's position, the taxpayer's position is undoubtedly preferable. The taxpayer provides a logical and sensible answer to the question, whereas the government fails to offer a coherent or supportable alternative.

II. Parties' Positions

The basic points of the taxpayer's position are straightforward. Section 3402(a)(1) requires that any employer paying wages withhold income tax on those wages. Section 3402(o)(1)(A) provides that SUBs, as defined in section 3402(o)(2)(A), are to be treated as though they were wages for income tax withholding purposes:

> For purposes of this chapter . . . any supplemental unemployment compensation benefit paid to an individual . . . shall be treated as if it were a payment of wages by an employer to an employee for a payroll period.

Section 3402(o)(2)(A) defines SUBs for purposes of section 3402(o)(1)(A):

> For purposes of paragraph (1), the term ''supplemental unemployment compensation benefits'' means amounts which are paid to an employee, pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary), resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

Thus, SUBs are defined in section 3402(o)(2)(A) as benefits paid for unemployment ''resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions.'' And under section 3402(o)(1)(A), any SUB as defined in section 3402(o)(2)(A) ''shall be treated as if it were a payment of wages'' for purposes of income tax withholding. Consequently, any SUB is subject to income tax withholding. The definition of SUBs in section 3402(o)(2)(A) contains no requirement that the benefits be tied to state unemployment compensation benefits.

Although section 3402(o)(1)(A), by its explicit terms, applies only for purposes of income tax withholding, the Supreme Court in *Rowan Companies Inc. v. United States*[4] held that the term ''wages'' should ordinarily have the same meaning for FICA purposes that it has for income tax withholding purposes because of the similar statutory definitions of the term for those two purposes. The *Rowan* Court thus invalidated Treasury regulations that treated the value of meals and lodging provided to employees for the convenience of the employer as wages for FICA purposes but not for income tax withholding purposes.

The taxpayer in *Quality Stores* maintains that section 3402(o)(1)(A)'s explicit requirement that SUBs, as defined in section 3402(o)(2)(A), be treated *as though* they were wages for income tax withholding purposes means that in the absence of that statutory rule, those benefits would be *excluded* from wages for income tax withholding purposes. Relying on the *Rowan* principle that the term ''wages'' ordinarily should have the same meaning for both FICA and income tax withholding purposes, the taxpayer argues that because there is no comparable statutory provision treating SUBs as

[3]For discussions of the flaws in the government's reliance on the revenue rulings, see Brief of Appellees Quality Stores Inc., et al. at 52-58, *United States v. Quality Stores Inc.*, 693 F.3d 605 (6th Cir. 2012) (No. 10-1563); Amicus Brief of the American Payroll Association in Support of the Appellees and with the Consent of the Parties at 17-22, *Quality Stores*, 693 F.3d 605 (No. 10-1563); Amicus Curiae Brief of the ERISA Industry Committee in Support of Appellees' Position at 24-25, *Quality Stores*, 693 F.3d 605 (No. 10-1563).

[4]452 U.S. 247 (1981).

though they were wages for FICA purposes, the benefits should not be treated as wages for FICA purposes.

The government's position is that the definition of wages for FICA purposes applies broadly to all benefits provided by employers to their employees, with the exception of benefits that have been specifically exempted. For SUBs to be excluded from FICA wages, according to the government, the benefits must satisfy the requirements set forth in the revenue rulings. However, the government fails to explain the legal basis for its reliance on the revenue rulings or the legal basis for the requirements themselves.

On appeal in both *Quality Stores* and *CSX*, the government argued that the *Rowan* principle was statutorily overruled by a subsequent decoupling amendment to the definition of FICA wages in section 3121(a), which reads:

> Nothing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter.

The government relied on committee report language that described the effect of the decoupling amendment as follows:

> The determination of whether or not amounts are includible in the social security wage base is to be made without regard to whether such amounts are treated as wages for income tax withholding purposes.[5]

The Sixth Circuit and the Federal Circuit disagreed on the ultimate issue of whether section 3402(o)(2)(A) determines which SUBs are excluded from taxable wages for FICA purposes. However, both courts rejected the government's reliance on the committee report language to support a conclusion that the decoupling amendment had overruled *Rowan*'s general principle of parallelism in the meaning of wages for FICA and income tax withholding purposes.

The courts concluded that the statutory language the committee reports purported to describe clearly did not have the broad effect claimed. Rather, both courts concluded the statutory language related instead only to the effect that regulations establishing exclusions from "wages" for income tax withholding purposes have on the meaning of "wages" for FICA purposes. Both courts concluded that despite the committee report's claim to the contrary, the statutory language said nothing about the relationship between "wages" for FICA purposes and "wages" for income tax withholding purposes on any issue for which the regulations do not provide an exclusion from wages for income tax withholding purposes.

Both circuits concluded that the taxpayer's position on SUBs was based not on an income tax withholding exclusion established by regulation, but rather on a provision of the income tax withholding statute itself. As a result, both courts found that the decoupling amendment had no bearing on the merits of the taxpayer's position regarding the significance of section 3402(o)(2)(A) for FICA purposes.

The government's petition for certiorari in *Quality Stores* does not include the decoupling amendment argument. It thus appears that the government has either accepted the conclusion reached by the Sixth and Federal circuits or at least decided that the Supreme Court likely would agree with them.

However, the government continues to rely on a separate statutory change concerning the treatment of so-called dismissal pay. Dismissal payments were excluded from the FICA definition of wages until 1950, when Congress eliminated the exclusion. The government contends that in light of that statutory change, all severance payments necessarily constitute wages for FICA purposes.

Responding to that argument on appeal, the *Quality Stores* taxpayer asserted that the eliminated exclusion was only for dismissal payments that the employer was not legally required to make and that the 1950 amendment therefore did not automatically make all dismissal payments wages.[6] The taxpayer argued that dismissal payments are not equivalent to SUBs as defined in section 3402(o)(2)(A).[7] For example, dismissal payments include payments made when an employee is terminated for cause rather than as a result of a reduction in the employer's business operations.

The taxpayer also claimed that the government's position was inconsistent with the revenue rulings on which it relied. The revenue rulings recognize that specified SUBs are excluded from wages for FICA purposes, even though the particular benefits covered by the revenue rulings clearly would be considered dismissal payments and thus taxable wages under the government's theory.[8]

---

[5]H.R. Rep. No. 98-47, at 148 (1983); *see also* S. Rep. No. 98-23, at 42 (1983); H.R. Rep. No. 98-25, at 80 (1983).

[6]Brief of Appellees, *supra* note 3, at 27 and 28-29.

[7]*Id.* at 29.

[8]*Id.* at 31.

The government challenges the inference that the taxpayer draws from the existence of section 3402(o)(1)(A): that in its absence, all the SUBs covered by that provision would be excluded from wages for income tax withholding and FICA purposes.[9] The government maintains that the purpose of section 3402(o)(1)(A) was not to establish that SUBs are not taxable wages for FICA purposes but rather to rectify the problem created by the lack of income withholding on benefits that were nevertheless included in the recipients' taxable income.

Moreover, the government contends that regardless of the implications for income tax withholding purposes, the existence of section 3402(o)(1)(A) has no implications for FICA purposes. However, that argument ignores that in all the revenue rulings issued before the enactment of section 3402(o), the IRS's conclusion that the benefits at issue were excluded from wages applied for both FICA purposes and income tax withholding purposes. If the *Quality Stores* taxpayer is correct that the enactment of section 3402(o) means that without that provision, the benefits it covers would be excluded from wages for income tax withholding purposes, the same conclusion also should apply for FICA purposes.

The Federal Circuit's holding for the government in *CSX* was based on the court's acceptance of the government's argument that the existence of section 3402(o)(1)(A) does not mean that in the absence of this provision, all SUBs would be excluded from wages for income tax withholding purposes. In contrast, the Sixth Circuit agreed with the taxpayer's position. This point is clearly important in resolving the dispute.

However, the legal issue in *Quality Stores* cannot be decided by focusing exclusively on whether the taxpayer is correct in its position that the statutory definition in section 3402(o)(2)(A) determines which SUBs are excluded from taxable wages for FICA purposes. A proper resolution requires considering as well the merits of the government's position that the revenue rulings are determinative.

In rejecting the *CSX* taxpayer's argument that the statutory definition in section 3402(o)(2)(A) controls, the Federal Circuit did not address whether the revenue rulings are substantively correct or whether there is legal authority for the revenue rulings to determine the FICA treatment of particular benefit payments. Instead, the Federal Circuit simply accepted the government's argument that because the taxpayer had not asserted that the benefit payments at issue met the requirements in the revenue rulings, the payments were taxable wages for FICA purposes.

When the issue in *Quality Stores* is evaluated from the perspective of the parties' opposing positions, the taxpayer's approach, which is based on a coherent line of reasoning, is clearly preferable.

III. Discussion

The fundamental problem with the government's position is that it offers no real alternative to the taxpayer's approach. What the government instead offers is an unsatisfactory, incoherent combination of partial positions.

The government maintains that the benefits in *Quality Stores* do not come within the category of SUBs that are excluded from taxable wages for FICA purposes because the benefits are not covered by any of the revenue rulings the IRS has issued on this subject. However, the government has made no effort to defend the conclusions reached in those revenue rulings. Instead, it simply contends that the correctness of those conclusions is not at issue in the case.

Yet, the government repeatedly asserts that the reason the benefits cannot be excluded from taxable wages for FICA purposes is because they do not satisfy the requirements of the revenue rulings. To evaluate the government's position that the revenue rulings control, one must review the principles that apply in determining the legal status of agency documents.

A. Framework for Analysis

The framework for determining the status of agency guidance was clarified by the Supreme Court in *Mayo Foundation for Medical Education and Research v. United States*.[10] *Mayo* did not deal directly with IRS guidance documents such as revenue rulings, but it made clear that the validity of IRS regulations must be evaluated under the same standard that applies for all other agencies, namely, the two-part test set forth in *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*[11]

In reaching that conclusion, *Mayo* established more generally that judicial review of IRS action is subject to the same rules and principles that apply in the judicial review of action by any other federal agency:

> We are not inclined to carve out an approach to administrative review good for tax law only. To the contrary, we have expressly recognized

[9]Brief for the Appellant at 40-41, *Quality Stores*, 693 F.3d 605 (No. 10-1563).

[10]131 S. Ct. 704 (2011).

[11]467 U.S. 837 (1984).

> ''the importance of maintaining a uniform approach to judicial review of administrative action.''[12]

United States v. Mead Corp.[13] had previously clarified that not all agency guidance is evaluated under the *Chevron* two-part test and it addressed the weight that courts should give documents that are ineligible for *Chevron* deference. *Mayo*'s reference to ''the importance of maintaining a uniform approach to judicial review of administrative action'' leaves no doubt that *Mead*'s clarification of the *Chevron* framework fully applies in tax cases.

Mead established that agency guidance documents are eligible to be evaluated under the *Chevron* two-part test and are therefore eligible to receive *Chevron* deference, only if ''Congress delegated authority to the agency generally to make rules carrying the force of law, and . . . the agency interpretation claiming deference was promulgated in the exercise of that authority.''[14]

Thus, the only agency documents eligible for *Chevron* deference are those that the agency intended to have the force of law. As a result, generally only relatively formal agency guidance documents, such as regulations, are eligible for *Chevron* deference. The agency's use of notice and comment procedures to issue guidance usually shows the agency intended the guidance to have the force of law, and guidance issued under those procedures ordinarily will receive *Chevron* deference.[15]

Mead also clarified that agency guidance documents that are ineligible for *Chevron* deference because, for example, the agency did not intend them to have the force of law, are not automatically given no weight by a reviewing court. Instead, they are given the level of deference determined under the standard articulated in *Skidmore v. Swift & Co.*[16] Under that standard, agency guidance receives weight based on the document's ''power to persuade,'' which depends on ''the thoroughness evident in its consideration; the validity of its reasoning; its consistency with earlier and later pronouncements; and all those factors which give it power to persuade, if lacking power to control.''[17]

When the *Mead* test is applied to revenue rulings, it is clear that they are ineligible for *Chevron* deference. Revenue rulings are not issued using notice and comment procedures, and the IRS does not claim that revenue rulings have the force of law.[18] In any event, in litigating *Quality Stores*, the government explicitly disavowed any claim that the relevant revenue rulings should be evaluated under *Chevron*. It would be surprising if the government were to change its position on that point in the Supreme Court.

Thus, it is clear that IRS revenue rulings are evaluated under the *Skidmore* ''power to persuade'' standard and not under *Chevron*'s two-part test.[19] While agency guidance documents evaluated under *Chevron* can establish law if they satisfy both parts of the test, documents evaluated under the *Skidmore* standard cannot establish law. For guidance evaluated under *Skidmore*, even in cases in which the reviewing court adopts the agency's position expressed in the guidance, the court's reason for adopting that position is not because it establishes the law but only because the reviewing court finds the agency position persuasive.

B. Application of *Skidmore* Standard

Under *Skidmore*, the revenue rulings on which the government relies in *Quality Stores* would be given little if any weight because of their lack of reasoning and the inconsistency among the positions they express.

The most obvious inconsistency concerns whether the benefits must be tied to state unemployment compensation benefits to be excluded

---

[12]131 S. Ct. at 713.

[13]533 U.S. 218 (2001).

[14]*Id.* at 226-227.

[15]*Id.* at 230. For a discussion of the current status of the ''*Chevron* step zero'' issue regarding which agency guidance documents are evaluated under the *Chevron* two-part test, see Patrick J. Smith, ''*Chevron* Step Zero After *City of Arlington*,'' *Tax Notes*, Aug. 12, 2013, p. 713.

[16]323 U.S. 134 (1944).

[17]*Id.* at 140.

[18]For a discussion of this point, see Smith, ''Life After *Mayo*: Silver Linings,'' *Tax Notes*, June 20, 2011, p. 1251, at 1260, n.62. However, for a recent article concluding that any guidance published in the Internal Revenue Bulletin should be viewed as having the force of law but as being invalid if issued without notice and comment procedures, see Kristin E. Hickman, ''Unpacking the Force of Law,'' 66 *Vand. L. Rev.* 465, 529 (2013).

[19]*See, e.g.*, *Kornman & Associates Inc. v. United States*, 527 F.3d 443, 452-456 (5th Cir. 2008) (pre-*Mayo* case applying *Mead* and *Skidmore* to evaluate the weight to be given to an IRS revenue ruling); *PSB Holdings Inc. v. Commissioner*, 129 T.C. 131, 142-145 (2007) (same); *Taproot Administrative Services Inc. v. Commissioner*, 133 T.C. 202, 208-212 (2009) (same), *aff'd without deciding this issue*, 679 F.3d 1109, 1115, n.14 (9th Cir. 2012).

It is important to emphasize, however, that the considerations that apply when the taxpayer relies on the position taken in an IRS document are very different from those that apply when it is the IRS that relies on the position taken in that document with which the taxpayer disagrees. The Tax Court has held that the IRS will not be permitted to argue in litigation against a position taken in a revenue ruling; *see, e.g.*, *Rauenhorst v. Commissioner*, 119 T.C. 157, 170-173 (2002); and the IRS has advised its attorneys they are not permitted to do so; *see* CC-2003-014.

from taxable wages for FICA purposes. The IRS has reversed its position on that issue not just once, but twice.

In Rev. Rul. 56-249, 1956-1 C.B. 488, the benefits that were held to be excluded from taxable FICA wages were tied to the amount of state unemployment compensation benefits. However, in Rev. Rul. 77-347, 1977-2 C.B. 362, the IRS relied on the enactment of section 3402(o) to conclude that ''the fact that benefits under the plan are not tied to the State's unemployment benefits is not a material or controlling factor.'' Thus, in Rev. Rul. 77-347, the IRS reversed the position it had taken in Rev. Rul. 56-249 that benefits must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes. The government's petition for certiorari in *Quality Stores* completely ignores Rev. Rul. 77-347 and thus neither acknowledges nor attempts to explain the IRS's reversal of position.

The IRS reversed its position a second time in Rev. Rul. 90-72, 1990-2 C.B. 211, concluding that Rev. Rul. 77-347 was incorrect on this issue:

> The portion of Rev. Rul. 77-347 concluding that benefits do not have to be linked to state unemployment compensation in order to be excluded from the definition of wages for FICA and FUTA tax purposes is inconsistent with the underlying premises for the exclusion and is therefore hereby revoked. This action restores the distinction between SUB pay and dismissal pay by re-establishing the link between SUB pay and state unemployment compensation set forth in Rev. Rul. 56-249.

Rev. Rul. 90-72 based that conclusion on a determination that Rev. Rul. 77-347 was incorrect in relying on section 3402(o): ''Section 3402(o) is not applicable for FICA or FUTA purposes.'' Because the government's petition for certiorari ignores Rev. Rul. 77-347, it likewise fails to acknowledge the IRS's second reversal of position on this issue. Thus, under the *Skidmore* standard,[20] the fact that the IRS has twice reversed its position on whether benefits must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes means that the current IRS position is entitled to little if any weight.

Moreover, this is not the only FICA wage issue on which the IRS has flip-flopped in its revenue rulings. The IRS has also reversed its position — again not just once, but twice — on whether benefits paid in a lump sum can be excluded from taxable wages for FICA purposes.

The benefits excluded from FICA wages in Rev. Rul. 56-249 were not paid in a lump sum but instead paid over time. As noted in the petition for certiorari, Rev. Rul. 59-227, 1959-2 C.B. 13, applied the principles of Rev. Rul. 56-249 to plans that made lump sum rather than periodic payments to employees.[21] And in Rev. Rul. 90-72, the IRS again took the opposite position, ruling that benefits paid in a lump sum are not considered linked to state unemployment compensation benefits and are therefore not excluded from taxable wages for FICA purposes. While the petition for certiorari acknowledges the IRS's initial reversal on whether lump sum payments can be excluded from FICA wages (without acknowledging that it was a reversal),[22] the petition neither acknowledges nor attempts to explain the IRS's second reversal on this issue.

Thus, the IRS has twice reversed its position on two different issues concerning which benefits are excluded from FICA wages. Under the *Skidmore* ''power to persuade'' standard, the agency's inconsistency within the revenue rulings makes it difficult for the current IRS position to receive any deference at all.

The other feature of the revenue rulings that seriously undermines their persuasiveness and thus their weight under *Skidmore* is the lack of reasoning given to support their substantive positions. Rev. Rul. 56-249, the revenue ruling in which the IRS first determined that some SUBs could be excluded from taxable wages for FICA purposes, contains no reasoning at all; it simply provides an extensive description of the terms of the benefit plan at issue.

Although Rev. Rul. 90-72, the latest revenue ruling in the series, contains a small amount of reasoning, it is superficial and conclusory. Rev. Rul. 90-72 expressed the position that benefits must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes, but the ruling did not explain the basis for that position or for the position that benefits not tied to state unemployment compensation benefits cannot be excluded from FICA wages. Moreover, neither the IRS nor the Justice Department has ever provided an explanation.

Given the substantial internal inconsistencies among the revenue rulings and the lack of any satisfactory explanation for the positions they adopt, under *Skidmore*, those positions should be

[20]Agency inconsistency over time is irrelevant in evaluating the agency position under the second part of the two-part *Chevron* test. However, as discussed above, it is clear that IRS revenue rulings are not evaluated under the *Chevron* two-part test.

[21]Petition for Cert., *supra* note 1, at 12-13.

[22]*Id.*

given very little weight in determining which SUBs are excluded from taxable wages for FICA purposes.

Moreover, the government's arguments in *Quality Stores* are inconsistent with the terms of the revenue rulings. In addition to emphasizing that wages are defined broadly for FICA purposes, the government draws support from the fact that the benefits at issue were based on the length of the employee's service with the company and the level of the employee's regular compensation:

> When, as here, the amount of a payment to a departing employee is based on factors like the employee's salary and years of service to the company, those factors indicate that the payment is compensation for past services rendered by the employee.[23]

However, that argument directly conflicts with the terms of the revenue rulings on which the government relies as establishing the controlling tests for benefits' FICA treatment. Rev. Rul. 56-249 clearly states that the benefits at issue in that ruling were based in part on the duration of an employee's service with the employer and the level of the employee's regular compensation:

> The benefits payable from the fund are to be in varying amounts and for varying periods, depending on the size of the fund, duration of layoff of an employee, *time worked prior to layoff*, amount of State unemployment benefits available, *and the base hourly-rate of the individual employee*, less taxes withheld. [Emphasis added.]

Moreover, Rev. Rul. 90-72, in describing the relevant factors from Rev. Rul. 56-249, included those same factors, noting that "the amount of weekly benefits payable is based [in part] upon . . . the amount of straight-time weekly pay," and that "the duration of the benefits is affected by . . . the employee's seniority." The government does not acknowledge or attempt to explain that significant inconsistency.

Either the government's position in *Quality Stores* on the relevance of those factors is wrong, or the revenue rulings are incorrect in concluding that benefits displaying those characteristics are excluded from FICA wages. Either alternative seriously damages the government's position in the case.

C. Other Flaws in the Government's Position

The government's Sixth Circuit briefs in *Quality Stores* seem to recognize the weakness of the position that the revenue rulings establish the law regarding which SUBs are excluded from taxable wages for FICA purposes. Those briefs disavow any attempt to defend the correctness of the tests in the revenue rulings and instead are devoted to attacking the taxpayer's position that the statutory definition controls.

For example, the government asserts that "the merits of the linkage requirement of Rev. Rul. 90-72 are not at issue here."[24] Yet, the government relies on that requirement — the tie to state unemployment compensation benefits — as part of the reason why the benefits in *Quality Stores* supposedly do not qualify as the types of SUBs excluded from FICA wages.[25]

The government claims it is not asserting *Chevron* deference for the revenue rulings:

> Debtors (and amici) argue at length that Rev. Rul. 90-72 and the other Revenue Rulings addressing SUB pay are not entitled to judicial deference . . . but the Government has made no such argument before this Court.[26]

However, that claim is inconsistent with the government's arguments that the revenue rulings represented the "present law" that is described in the committee report relating to the enactment of the statutory definition:

> The Committee Report was merely reciting "present law," and the source of that "present law" was the very Revenue Rulings that Debtors disavow.[27]

If the revenue rulings do not receive *Chevron* deference, as the government acknowledges they do not, it is impossible for them to represent law, because *Chevron* deference applies only to agency pronouncements that have the force of law.[28]

Thus, agency documents that do not receive *Chevron* deference necessarily do not have the force of law and could not possibly be the "present law" referred to in the committee report. That the committee report preceded *Chevron* does not affect this

---

[23]*Id.* at 23.

[24]Reply Brief for the Appellant at 32, *Quality Stores*, 693 F.3d 605 (No. 10-1563).

[25]Brief for the Appellant, *supra* note 9, at 31-32.

[26]Reply Brief for the Appellant, *supra* note 24, at 28. *See also* Petition for Rehearing *en banc* at 7-8, *Quality Stores*, 693 F.3d 605 (No. 10-1563) ("Although the Government has not argued for deference to the Revenue Rulings, the panel rejected them as inconsistent with the 'expressed will of the legislature'").

[27]Reply Brief for the Appellant, *supra* note 24, at 11. *See also* Brief for the Appellant, *supra* note 9, at 39 (The statement in the committee report "was a recitation of 'present law,' which necessarily refers to the IRS's Revenue Rulings regarding SUB pay").

[28]*See Mead*, 533 U.S. at 226-227.

analysis, because, as *Mead* makes clear, before *Chevron*, agency documents such as IRS revenue rulings were evaluated under *Skidmore*, which clearly does not accord the force of law to those documents.

The government's claim that it is not asserting *Chevron* deference for the revenue rulings is also inconsistent with its position that because the benefit plans in *Quality Stores* do not satisfy the requirements reflected in the revenue rulings, payments under those plans do not qualify as SUBs that are excluded from FICA wages. Failure to satisfy the requirements reflected in the revenue rulings could have that consequence only if the revenue rulings established the law on this issue.

The section of the government's opening brief headed ''Statement of the Issue'' makes this tension clear:

> Whether the courts below erred in holding that the severance payments at issue, which admittedly did not qualify for exclusion from Federal Insurance Contributions Act tax under Rev. Rul. 90-72, 1990-2 C.B. 211 (excluding certain supplemental unemployment compensation benefits from FICA tax), nevertheless did not constitute ''wages'' for FICA tax purposes.[29]

An essential part of the government's position in *Quality Stores* is that the benefits do not qualify for exclusion from taxable wages for FICA purposes under the revenue rulings. Consequently, the status of the revenue rulings is clearly at issue in the case:

> Although the IRS has ruled, in Rev. Rul. 90-72, that dismissal payments that meet the requirements delineated therein are not subject to FICA tax, there is no dispute that the severance payments at issue do not qualify for such exclusion because they were not dependent upon eligibility for, or receipt of, state unemployment compensation.[30]

And yet the government presented no arguments for why the position in the revenue rulings is controlling or correct. Instead, as noted above, it explicitly asserts that the correctness of the linkage requirement expressed in Rev. Rul. 90-72 is not at issue in *Quality Stores*.

The government's position that the revenue rulings establish the law is inconsistent with the terms of the rulings themselves, which do not purport to establish law. Nor do the revenue rulings purport to establish a comprehensive set of rules to determine which benefit plans provide SUBs that will be excluded from FICA wages. And, for the most part, the revenue rulings do not purport to say which factors are necessary for the results they reach. Even for the most contested factor, the link to state unemployment benefits as allegedly required by Rev. Rul. 90-72, the revenue ruling does not explain what the nature of the link must be.

The government says the revenue rulings have ''carved out a limited exception for certain types of dismissal pay,''[31] but it does not attempt to justify the existence of the carveout. Most provocatively, the government acknowledges that the IRS's authority to create the carveout could be questioned, but it dismisses the issue by noting that taxpayers have complained only about the scope of the carveout, not its creation:

> While one could argue . . . that the IRS lacked authority to carve out an exclusion for SUB pay meeting the requirements of the Revenue Rulings in light of Congress's treatment of dismissal pay, taxpayers obviously have not clamored to do so inasmuch as the exclusion lowers their tax burden.[32]

The government may mean to suggest here that in defining a carveout from treatment as taxable FICA wages for some SUBs, the IRS has simply allowed taxpayers a benefit to which they would not otherwise be entitled, and that taxpayers accordingly cannot complain about the terms of the tax benefit. If that is the case, the government has failed to explain the source of the IRS's authority to allow that tax benefit for some taxpayers and not others, or the propriety of the particular point at which the IRS has arguably drawn the line between SUBs that are eligible for exclusion from FICA taxation and those that are not. The IRS's failure to provide those explanations would subject the positions taken in the revenue rulings to challenge under the Administrative Procedure Act's arbitrary and capricious standard by taxpayers whose benefit plans do not satisfy the requirements reflected in the revenue rulings.[33]

---

[29]Brief for the Appellant, *supra* note 9, at 3. *Id.* at 10 (''The Government noted that although certain types of SUB pay are excluded from FICA tax as a result of a series of IRS Revenue Rulings beginning with Rev. Rul. 56-249, 1956-1 C.B. 488, and culminating with Rev. Rul. 90-72, 1990-2 C.B. 211, the severance payments at issue did not qualify under Rev. Rul. 90-72 because, among other things, they were not dependent upon the receipt of state unemployment compensation'') (describing argument made in the bankruptcy court).

[30]*Supra* note 28, at 22.

[31]*Id.* at 22, 31.

[32]Reply Brief for the Appellant, *supra* note 24, at 10.

[33]*See* 5 U.S.C. section 706(2)(A). For discussions of the arbitrary and capricious standard, see Smith, ''The APA's Arbitrary and Capricious Standard and IRS Regulations,'' *Tax Notes*, July 16, 2012, p. 271; and Smith, ''The APA's Reasoned-Explanation Rule and IRS Deficiency Notices,'' *Tax Notes*, Jan.

(Footnote continued on next page.)

The government's equivocation on the status of the revenue rulings continues in its petition for certiorari. For example, the petition never asserts that Rev. Rul. 90-72 is *correct* in its position that benefits must be tied to state unemployment compensation benefits in order to be excluded from taxable wages for FICA purposes. Instead, the petition merely says that in Rev. Rul. 90-72, ''the IRS *set forth* in detail *its position* on . . . the criteria that govern the determination whether particular payments to terminated employees are FICA 'wages.'''[34] Likewise, for the IRS position stated in Rev. Rul. 90-72, the petition merely says that ''*under that approach*, the severance payments at issue here clearly are not exempt from FICA taxation because they are wholly unconnected to state unemployment compensation.''[35]

However, in describing why the government believes section 3402(o) is irrelevant, the petition for certiorari clearly relies on the revenue rulings as the basis for the government's belief that the benefits at issue are not excluded from FICA wages:

> The provision does not explicitly address, and has no logical bearing on, the determination whether particular payments to terminated employees are subject to FICA taxation. *Rather, that determination is governed by other provisions of law*. And, once Section 3402(o) is understood to be irrelevant to questions of FICA taxation, the severance payments at issue here clearly constitute FICA ''wages.'' See pp. 8-14, *supra*.[36]

The cited pages conclude with the discussion of Rev. Rul. 90-72 that includes the statements quoted above. Thus, as in the government's Sixth Circuit briefs, the petition for certiorari adopts inconsistent positions on the status of the revenue rulings. The petition refrains from endorsing the merits of the revenue rulings, yet it relies on them as the basis for the government's argument on the FICA treatment of the SUBs at issue. The petition even seems to refer to the revenue rulings as falling into the category of ''other provisions of law.''

Thus, the government's position on the status of the revenue rulings remains as incoherent and unsupported in the petition for certiorari as it was in the Sixth Circuit.

IV. Conclusion

Without an explanation for why the government believes a series of IRS revenue rulings controls the legal issue of which SUBs are excluded from taxable wages for FICA purposes, or why the most recent of those revenue rulings concluded that benefits cannot be excluded unless they are tied to state unemployment compensation benefits, the government's position in *Quality Stores* is incoherent and unsupported.

In contrast, the taxpayer has presented a coherent, sensible, and easily understood explanation of the basis for its position. Given the choice between that position and the government's position, it is clear that the taxpayer's position is preferable.

16, 2012, p. 331. As discussed in the latter article, it is clear that the arbitrary and capricious standard applies to all agency action, not just rulemaking. *Smith*, at 332; *see also Citizens to Preserve Overton Park Inc. v. Volpe*, 401 U.S. 402, 413-414 (1971) (''*In all cases* agency action must be set aside if the action was 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law'''') (emphasis added).

[34]Petition for Cert., *supra* note 1, at 14 (emphasis added).

[35]*Id.* (emphasis added).

[36]*Id.* at 20 (emphasis added).