Tenure Buyouts: Employment Death Taxes and the Curious Obesity of "Wages"

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ARTICLES

TENURE BUYOUTS: EMPLOYMENT DEATH TAXES AND THE CURIOUS OBESITY OF “WAGES”

Bobby L. Dexter*

ABSTRACT

In recent years, tenure buyouts at universities across the nation have become increasingly common. To the extent that buyout negotiations result in lump sum payments, payroll tax issues arise because such payments may be viewed as “wages” with respect to “employment.” Using a current split in the U.S. Courts of Appeals as an analytical springboard, this Article argues that the burgeoning demands of the Social Security and Medicare programs have generated expansionist pressure on the “wages” concept in the tax arena and
explores the difficulties courts have encountered in delineating the unique payroll tax, general income tax, and Social Security benefits conceptions of the term.
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I. Introduction

Prior to January of 1994, institutions of higher education could appeal to an exemption in the Age Discrimination in Employment Act of 1967 to force the retirement of tenured faculty members who had attained the age of seventy. With the expiration of that exemption, tenured faculty members may now retire well after that age, and for various personal and professional reasons, the postponement phenomenon is widespread. In addition to highly legitimate fears regarding the availability and cost of health insurance during the retirement years, senior tenured faculty may perceive imminent professional exclusion despite having robust ability to continue making substantial contributions to the institution’s pedagogical and scholarly missions. They may not be able to teach on a part-time basis or supervise students; indeed, enviable office space, lab space, and professional travel allocations may disappear overnight. Accordingly, and especially in light of the age-based demographics of the tenured professoriate, one can expect the contingent of faculty members postponing retirement to get larger as time goes on; only a few years ago, the National Study of Postsecondary Faculty indicated that 44.4% of all tenured faculty members were fifty-five or older.

For those institutions with a substantial number of senior tenured faculty members, a tenure buyout system may have considerable appeal. The “new” faculty line allows the school to bring in fresh talent at a lower salary, and, presumably, the university will reap the various benefits traditionally associated with the hiring of new faculty (i.e., an infusion of new ideas and a reinvigoration of the institution’s scholarly output). Their considerable appeal notwithstanding, however, tenure buyouts can be decidedly problematic for both the institution and the faculty member. To the extent the buyout is

4. See id. at 28.
5. See id. at 29.
6. Id. at 25.
7. Id. at 26.
8. See ENDING MANDATORY RETIREMENT, supra note 2, at 1.
negotiated and leads to one or more lump sum payments of cash (as is commonly the case), one can surely expect the prompt and rapt attention of the Internal Revenue Service.

While neither the universities nor the retiring professors have disputed the fact that the lump sum payments must be included in income, there is a real issue as to whether these amounts are legitimately subject to payroll taxes. Per the Internal Revenue Code, payroll taxes are imposed only on an individual’s “wages” with respect to “employment” (i.e., “any service, of whatever nature, performed . . . by an employee for the person employing him . . . “)). In the opinion of the United States Court of Appeals for the Third Circuit, as set forth in University of Pittsburgh v. United States, tenure relinquishment payments readily qualify as “wages” with respect to “employment” because, in the court’s view, an individual earns tenure largely by rendering services to the university; thus, payments to relinquish tenure link inexorably to services previously rendered. The United States Court of Appeals for the Eighth Circuit disagrees. In North Dakota State University v. United States (“NDSU”), the court emphasized that the grant of tenure is not automatic. Rather, it is selective, and once granted, the university may not deprive a faculty member of tenure without substantive justification and procedural due process. To the extent that a tenure relinquishment payment compensates the faculty member for anything, reasoned the court, it is not for services previously rendered. Part II of this Article places the payroll tax discourse in a broader context by providing useful background information on the Social Security system. This Part also serves to highlight the fact that expanding or narrowing the ambit of payroll tax “wages” has far-reaching impact, given that payroll tax revenues fund not only Social Security and Medicare programs but also, via the so-called “Social Security Trust Fund,” general government expenditures. In Parts III and IV, I present and assess the merits of the

10. Id. at § 3121(b).
11. 507 F.3d 165, 174 (3d Cir. 2007).
12. 255 F.3d 599, 605 (8th Cir. 2001).
13. Id.
14. Id. at 607.
16. See Neil H. Buchanan, Social Security and Government Deficits: When Should We Worry?, 92 CORNELL L. REV. 257, 272 (2007). Ideally, Social Security would entail an overt and true earmarking of specific taxes for the care of the elderly and the disabled. Yet, the program’s funding mechanism has gradually morphed into a system of annual tax increases that, incrementally, serve to fund general
positions taken by the Third and Eighth Circuits and ultimately argue that, in light of recent authority, the Third Circuit’s position represents judicial overreach because it imports a definitional standard from the world of the Social Security Act into the tax arena despite clear and wise exhortation not to indulge that tendency.\textsuperscript{17} Viewing the Circuit split as a mere icicle hanging from a glacier, I go on to argue that burgeoning entitlement program needs and virtually chronic federal budget woes have exerted expansive pressure on the “wages” concept. Worsening matters is the fact that payroll tax policies glide quietly under the public radar screen because such policies rarely get focused attention on the political stage. Contributing to this oversight, tax academics have historically devoted themselves largely to progressive income taxation policy, at the neglect of payroll tax policy.\textsuperscript{18} Accordingly, and especially given the ease of silent piggybacking on the employer-employee relationship, the payroll tax machinery is capable of truly admirable stealth, which pays off rather handsomely in the form of substantial revenue from low- and mid-wage earners.\textsuperscript{19} In Part V, I explore the evolution of the “wages” concept in the tax arena, noting the difficulties encountered in segregating the payroll tax, general income tax, and Social Security benefits conceptions of “wages.” Even in acknowledging that lines of demarcation exist, I emphasize that some are clear and that others are far more difficult to discern and/or justify. Finally, in Part VI, I conclude with additional commentary and a review of my primary points.

\begin{footnotesize}
17. \textit{See generally} United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 215 (2001) \textup{(}noting that “wages paid” need not mean the same thing in the distinct tax and Social Security benefits eligibility contexts\textup{)}. 
\end{footnotesize}
II. THE COMING STORM AND THE NEED FOR CLARITY

A full appreciation of the environment in which the current payroll tax “wage” concept operates necessarily dictates a broader discussion of the Social Security system, the problems it faces, and the link between payroll taxes, the FICA Wage Base, the Social Security Trust Fund, and the larger federal budget. With that necessary background in hand, one can more readily appreciate the various issues associated with overt payroll tax reform and the impact of illegitimately expansionist “wage” conceptions.

A. The Social Security Act of 1935

The current panoply of available Social Security benefits arose largely as a response to the Great Depression of the early 1930s, which ravaged the lifetime savings of retired workers and substantially reduced overall employment opportunities for the able-bodied.20 Responding to the crisis, President Franklin D. Roosevelt introduced economic security legislation in the form of the Social Security Act, ultimately signed into law on August 14, 1935.21 Over the years, program coverage broadened substantially such that benefits became available to the dependents of retired workers, surviving dependents of deceased workers, the disabled, and dependents (including surviving dependents) of the disabled.22 Benefit eligibility, of course, has never been automatic. Since their inception, the various Social Security programs have maintained a strong “social insurance” character.23 The programs exist to insure the replacement of income lost due to the death,

20. See Wikipedia.com, Federal Insurance Contributions Act Tax, http://en.wikipedia.org/wiki/FICA (last visited Aug. 17, 2008). Before the Great Depression, several distinct problems faced working-class Americans. Id. In the absence of federal-government-mandated programs requiring retirement savings or providing health insurance for the elderly, those who lived to retirement age and left the work force lost both their regular income stream and the ability to pay for necessary medical care. Id. Similarly, those injured on the job (or those born with congenital defects) could expect no disability benefits. Id. The New Deal introduced Social Security (funded by FICA taxes) as a means of correcting retirement and disability-related problems. Id. Later, in the 1960s, Medicare (funded by a separate tax) was introduced to address the problem of providing health care for the elderly. Id.


23. Id. at 3.
disability, or retirement of a principal breadwinner, but the benefits attach only to those who have worked in jobs subject to Social Security payroll taxes for the requisite time period (currently, forty calendar quarters) at sufficient wages (currently, $1,050 for one quarter of credit). Assuming clearance of the “amount earned” and “time-worked” hurdles, an individual earns protection against specific risks/eventualities “as a matter of earned right” both for himself and his qualifying beneficiaries.

As programs go, Social Security started out as one of the truly great ideas. Yet, several years ago, President Clinton issued a grim warning concerning the status of Social Security:

Early in this century, being old meant being poor. When President [Franklin D.] Roosevelt created Social Security, thousands wrote to thank him for eliminating what one woman called “the stark terror of penniless, helpless old age.” Even today, without Social Security, half our nation’s elderly would be forced into poverty. Today, Social Security is strong, but by 2013, payroll taxes will no longer be sufficient to cover monthly payments. By 2032, the trust fund will be exhausted[,] and Social Security will be unable to pay the full benefits older Americans have been promised.

Thus, with 2013 fast approaching and 2032 arriving as many currently-working adults reach or approach 65, President Franklin Roosevelt’s vision...
of Social Security—an untouchable promise of future payment extended in exchange for current payment of payroll taxes—may ultimately falter. If the failure should come to pass, that reality will, of course, substantially offend the social insurance model; the broad contribution base we enjoy should afford everyone who has contributed to the system the opportunity to receive adequate income when work ceases due to age or disability. But must the chicken necessarily come home to roost? After all, the employment tax contribution base is necessarily immense. Indeed, despite the withering objections of highly-paid professionals in the early years of the program, the contribution base gradually extended almost from the program’s inception. Properly assessing the question requires a slightly more comprehensive understanding of the payroll tax scheme and its link to the larger federal budget.

B. Payroll Taxes and the Federal Budget

The United States uses payroll taxes collected today to immediately pay

30. See Bernstein, supra note 29, at 62 (“We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions . . . . With those taxes in there, no damn politician can ever scrap my social security program.” (quoting President Franklin D. Roosevelt)).

31. See id. at 60.

32. See id. (“[O]nly a universal program has a contribution base broad enough to attain the goal of adequate benefits for all participants.”). The current system, which aims for adequate benefits, rejects a residualist model whereby an individual would collect from the system no more than he or she put in, even if that amount only afforded benefits at the poverty level. See id. at 59.

33. See id. at 73 (noting that the principles of universal coverage and universal taxation eventually outweighed any concerns about expanding the Social Security programs to cover highly-paid professionals).

34. See id. at 72-73. The expansion of the payroll tax scheme beyond industrial workers was gradual, but thorough. The program was extended to cover farm and domestic workers, then to self-employed farmers and professionals (except attorneys and physicians). While the physicians lasted longer than their brethren in the bar in fighting off inclusion, the tax scheme ultimately snared both doctors and lawyers. See id.

35. Both OASDI and Medicare are funded primarily by the collection of payroll taxes. Although employers and employees each bear responsibility for specific payroll taxes, § 3101 imposes those taxes on employees. Specifically, § 3101 imposes the 6.2% OASDI tax on “wages” received by an individual with respect to his “employment.” See I.R.C. § 3101(a) (2006). For the funding of Medicare, § 3101(b)(6) imposes a 1.45% tax on “wages” received with respect to an individual’s “employment.” Section 3121(a) of the Code generally defines “wages” as “all remuneration for employment, including the cash value of all remuneration . . . . paid in any medium other than cash . . . .” though there is a necessary statutory carveout for amounts earned beyond the FICA Wage Base. In the midst of subtleties, distinctions, and exceptions of limited significance here, § 3121(b) generally defines employment as “any service, of whatever nature, performed . . . by an employee for the person employing him . . . .” § 3121(b). Treasury Regulations interpreting § 3121 restate the basic statutory definition of “wages” as “all remuneration for employment unless specifically excepted . . . .” Treas. Reg. § 31.3121(a)-1(b) (2008). The regulations go
on to indicate that the name given to the remuneration (e.g., salaries, bonuses, commissions) is immaterial, as is the basis upon which the remuneration is paid (e.g., hourly, monthly, piecework, annually, etc.) and the medium in which it is paid (e.g., cash, goods, clothing, lodging, etc.). § 31.3121(a)-1(c)-(e). Notwithstanding an employee’s absence from work, vacation pay constitutes “wages,” as do certain payments made after the termination of the employer/employee relationship. § 31.3121(a)-1(g), (i). Thus, the regulations emphasize that “[r]emuneration for employment, unless such remuneration is specifically excepted . . . , constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.” § 31.3121(a)-1(i).

37. See id.
39. Id. at 271.
40. Id. (providing that the system was forced to collect more payroll taxes than would be paid out and that surpluses had to be accounted for in the Trust Funds).
41. Id. at 272-73.
42. Id. at 272 (demonstrating that rather than having the Trust Funds invested directly in the private financial markets, the “Trust Funds are simply ‘invested’ directly in Treasury securities” to reduce the amount of federal borrowing from the private financial markets). In the aggregate, the Trust Fund held approximately $1.858 trillion at the end of 2005. Id. This amount indicates that the so-called Trust Fund is building at a pretty healthy clip. McMahon, supra note 16, at 1028 (“At the end of 2002, ‘the trust fund’ held approximately $1.4 trillion, meaning that cumulatively nearly $1.4 trillion dollars collected by the payroll tax ostensibly to fund Social Security and Medicare had been spent on general government operations.”).
43. See 2000 Green Book, supra note 22, at 5-6.
44. Buchanan, supra note 16, at 272.
either have to act or allow Social Security to languish.\textsuperscript{45} President Clinton warns that the rubber will hit the pavement in 2013, and we’ll burn through the stash of Treasury Bonds by 2032.\textsuperscript{46} Absent Congressional action, either benefit levels will fall or payroll taxes will increase.\textsuperscript{47} Most people with money to bet would likely put it on the latter possibility, not the former (at least in the early stages of crisis).

Are there practical alternatives? One might logically reason that before raising the payroll tax \textit{rates} across the board, Congress will first extract more payroll taxes by first increasing the FICA Wage Base,\textsuperscript{48} dramatically if need be. In his capacity as senator, current President Barack Obama proposed a plan to uncap the FICA Wage Base (albeit with a break built in from roughly $100,000 to $250,000) to dispense with (rather than merely accelerate) the historic trend of gradually increasing the FICA Wage Base.\textsuperscript{49}

Back in 1937, when the Social Security program was new, the FICA Wage Base was a mere $3,000,\textsuperscript{50} and the rate of tax was a similarly low 1%.\textsuperscript{51} Over the years, both the amount subject to tax and the rate imposed have gradually increased.\textsuperscript{52} Since 1990, however, the aggregate OASDI rate has held at 6.2%,\textsuperscript{53} at least on surface examination. As Table 1 demonstrates, the dirty work of regular tax increases—a slow-speed mugging of the middle class, some might say—has been re-verbalized as an annual, politically-
Regarding the importance of proper verbal packaging of tax increases, one commentator argues that “[t]he vehicle of the lottery allows government officials to raise revenue without mentioning the word ‘tax.’” Todd A. Wyett, Note, State Lotteries: Regressive Taxes in Disguise, 44 TAX L. W. 867, 871 (1991). He further argues that state lotteries are the most regressive tax in existence in the United States, reasoning that “[l]ottery revenues have been used by state legislators to avoid having to impose direct taxes on their constituents.” Id. at 867. Proper verbal packaging (or repackaging) also holds promise as a means of retaining various tax benefits. See Dorothy A. Brown, Race and Class Matters in Tax Policy, 107 COLUM. L. REV. 790, 790 (2007) (predicting the preservation of the Earned Income Tax Credit if related race and class information can be properly “packaged”).

Table 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual Social Security Wage Base</th>
<th>Maximum Annual Social Security Tax Withholding (Excluding Medicare)</th>
<th>Percentage Increase Relative to Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>$102,000</td>
<td>$6,324.00</td>
<td>4.61</td>
</tr>
<tr>
<td>2007</td>
<td>$97,500</td>
<td>$6,045.00</td>
<td>3.50</td>
</tr>
<tr>
<td>2006</td>
<td>$94,200</td>
<td>$5,840.40</td>
<td>4.66</td>
</tr>
<tr>
<td>2005</td>
<td>$90,000</td>
<td>$5,580.00</td>
<td>2.38</td>
</tr>
<tr>
<td>2004</td>
<td>$87,900</td>
<td>$5,449.80</td>
<td>1.03</td>
</tr>
<tr>
<td>2003</td>
<td>$87,000</td>
<td>$5,394.00</td>
<td>2.47</td>
</tr>
<tr>
<td>2002</td>
<td>$84,900</td>
<td>$5,263.80</td>
<td>5.59</td>
</tr>
<tr>
<td>2001</td>
<td>$80,400</td>
<td>$4,984.80</td>
<td>5.51</td>
</tr>
<tr>
<td>2000</td>
<td>$76,200</td>
<td>$4,724.40</td>
<td>4.95</td>
</tr>
<tr>
<td>1999</td>
<td>$72,600</td>
<td>$4,501.20</td>
<td>6.14</td>
</tr>
<tr>
<td>1998</td>
<td>$68,400</td>
<td>$4,240.80</td>
<td>4.58</td>
</tr>
<tr>
<td>1997</td>
<td>$65,400</td>
<td>$4,054.80</td>
<td>5.99</td>
</tr>
</tbody>
</table>

As the data indicates, the FICA Wage Base rises, on average, at a rate of 4.28% per year. Though the wage base ostensibly climbs as a result of

54. Regarding the importance of proper verbal packaging of tax increases, one commentator argues that “[t]he vehicle of the lottery allows government officials to raise revenue without mentioning the word ‘tax.’” Todd A. Wyett, Note, State Lotteries: Regressive Taxes in Disguise, 44 TAX L. W. 867, 871 (1991). He further argues that state lotteries are the most regressive tax in existence in the United States, reasoning that “[l]ottery revenues have been used by state legislators to avoid having to impose direct taxes on their constituents.” Id. at 867. Proper verbal packaging (or repackaging) also holds promise as a means of retaining various tax benefits. See Dorothy A. Brown, Race and Class Matters in Tax Policy, 107 COLUM. L. REV. 790, 790 (2007) (predicting the preservation of the Earned Income Tax Credit if related race and class information can be properly “packaged”).


56. The FICA Wage Base has an intriguing history. The wage base started at $3,000 in 1937, and the tax was imposed at the rate of 1% for Old Age and Survivors Insurance. ANNUAL STATISTICAL SUPPLEMENT, supra note 50. Over time, disability insurance (1957-1958) and hospital insurance (1966) were added to the scheme. Id. The OASDI wage base has gradually increased since 1937, though in prior decades, the wage base would remain the same for years. See id. For example, the wage base was $7,800...
increases in average national wages, the annual FICA Wage Base remains impervious to gripping recessions, stock market collapses, or any other economic shock because, by statute, it either remains the same or increases, regardless of then-prevailing wage levels. And even though many have enjoyed reductions in progressive income tax rates in recent years, the FICA tax rates have remained unchanged even though the “excess” could have been trimmed without a reduction in outgoing Social Security payments. If large scale tax reductions were put in the queue, why were FICA taxes overlooked? Would that overlooking was the worst of it. At the same time that progressive tax rates were falling, FICA Wage Base adjustments marched onward and upward, essentially turning up the heat (already beyond beneficiary need) on “tens of millions of men and women in offices, factories and fields across America who go to work every day trying to do right by their families.” Of course, working Americans enjoyed progressive rate reductions, but if vertical equity is a primary goal of our tax system, it makes more sense to ease the pressure on those bearing the brunt of regressive taxes by targeting employment tax relief or reductions before turning down the heat on the progressive side and most assuredly before handing out tax candy to those raking in capital gains. Unpleasant though they may be, FICA Wage Base adjustments are but one lick of the flame. The proper scope of payroll tax

57. See Annual Statistical Supplement, supra note 50, at 2.4 tbl.2.A3 & n.n.
58. Under the FICA Wage Base calculation formula, the base will either stay the same or increase; it will not go down. See Contribution and Benefit Base Calculation, http://www.ssa.gov/OACT/COLA/cbbd.html (last visited Nov. 10, 2008) (indicating that if new contribution and benefit base calculations produce a number lower than the current base, the base is not to be reduced).
61. Vertical taxpayer equity refers to the notion that those with higher levels of taxable income should pay tax at a higher rate on marginal income than those with lower levels of taxable income because such a system reduces the inequity of widely disparate incomes. See Klein, Bankman, Bitikzer & Stone, Federal Income Taxation 20 (8th ed. 1990). Horizontal equity refers to the notion that taxpayers who are similarly-situated (from a taxable income perspective) should shoulder the same tax burden. See id. at 19.
“wages,” the tax base itself, is not a well-settled matter. Accordingly, inter-
Branch\(^\text{62}\) and inter-Circuit\(^\text{63}\) differences have arisen over time, and the current
Third Circuit/Eighth Circuit rift serves as a fine example of the latter.

### III. Split in U.S. Courts of Appeals and IRS Activity

Although the Sixth Circuit’s decision in *Appoloni v. United States*\(^\text{64}\)
created a degree of contention with the Eighth Circuit’s holding in *NDSU*, one
could argue that for factual reasons, no clear inter-Circuit conflict arose until
the Fall of 2007 with the Third Circuit’s rendering of its decision in *University
of Pittsburgh*. A brief summary of each opinion follows. At that juncture, the
discussion shifts to the IRS and tracks not only its reactions to each of the
relevant opinions but also its gradual yet perplexing self-reversal on the key
issue at hand.

#### A. North Dakota State University (“NDSU”) v. United States (2001)

The employment tax issue in *NDSU* arose in connection with the
university’s early retirement program.\(^\text{65}\) Under it, certain tenured faculty
members and high-level administrators could retire early and receive a
negotiated amount from the university in exchange for their relinquishment of
tenure/employment.\(^\text{66}\) Originally, the university withheld employment taxes
from the payments,\(^\text{67}\) but in response to faculty inquiries regarding the
applicability of such taxes to retirement program payments, the university
sought guidance from the Social Security Administration.\(^\text{68}\) The
Administration responded that “as described by NDSU, the program was ‘in

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Congress consciously nullified the U.S. Supreme Court’s decision in *Rowan Cos. v. United States*, 452 U.S. 247 (1981). In that decision, the Court held that “wages” meant the same thing in the income tax withholding context and the FICA/FUTA context. See *id.*

\(^\text{63}\) Compare *Univ. of Pittsburgh v. United States*, 507 F.3d 165, 174 (3d Cir. 2007) (holding that
instructors receiving payments in exchange for relinquishing their tenure rights and retiring early had, in
fact, received “wages” subject to payroll taxes), and *Appoloni v. United States*, 450 F.3d 185 (6th Cir.
2006) (same), with *N.D. State Univ. v. United States*, 255 F.3d 599 (8th Cir. 2001) (holding that lump sum
payments to retiring faculty members as consideration for relinquishing tenure did not constitute “wages”
for FICA purposes).

\(^\text{64}\) 450 F.3d 185 (6th Cir. 2006).

\(^\text{65}\) 255 F.3d at 600-01.

\(^\text{66}\) *Id.* at 601.

\(^\text{67}\) *Id.* at 602.

\(^\text{68}\) *Id.*
effect, a payment to secure the release of an unexpired contract of employment, and as such, under the Social Security Procedure Operations Manuals, was not considered wages for purposes of determining benefit amounts or for deduction of benefits purposes. Accordingly, the university stopped withholding and paying over employment taxes with respect to the retirement payments. The IRS later audited the university and assessed deficiencies; having paid the assessed taxes and having been denied its request for a refund, the university filed suit.

Both the district court and the United States Court of Appeals for the Eighth Circuit held that lump sum payments made to tenured faculty members voluntarily retiring early were not “wages” with respect to prior service to the university but due consideration tendered for the relinquishment of the full panoply of rights, privileges, and protections afforded by “tenured” status. Thus, in their view, tenure itself constitutes a distinct property right that cannot be taken away without substantive justification and procedural due process. Rejecting the argument that tenure rights cannot be relinquished because they have no economic value that can be bought and sold, the Eighth Circuit reasoned that “[l]ack of a market in which to sell tenure rights does not prevent those rights from having value to the faculty member to whom tenure has been granted.” The court also responded to the argument that tenure rights accrue over time (and thus that the grant of tenure is a form of compensation for prior services) by asserting that “tenure is much more than a recognition for past services.” The court went on to point out that universities do not grant tenure automatically; in addition to teaching during

69. Id.
70. Id.
71. Id.
72. Id.
73. Id. at 607.
74. Note that administrators were held subject to FICA taxes. See id. at 608. Although it was argued that some administrators had tenure and should have been exempt from FICA taxation to the extent they participated in the early retirement program, see id. at 607, the court dismissed the undocumented factual allegations as “bald assertions.” Id. At least one commentator felt that tenured faculty members deserve no free ride here. See Heather L. Turner, Note, Disparate Treatment of University Administrators’ and Tenured Faculty Members’ Early Retirement Payments for FICA Taxation: North Dakota State University v. United States, 54 Tax Law. 233, 237 (2000) (arguing that payments made to both university administrators and tenured faculty members should have been subject to FICA taxation because payment amounts were based on employment factors such as length of service and previous salary).
75. N.D. State Univ., 255 F.3d at 605.
76. Id.
77. Id.
78. Id.
a probationary period, instructors must produce scholarship, conduct research, and serve the university and the larger community.79

B. Appoloni v. United States (2006)

In a degree of contrast, we have Appoloni v. United States.80 This case involved payments made for the relinquishment of tenure rights but did not involve university professors.81 Instead, the early retirement program participants were public school teachers who generally earned tenure automatically after completing a probationary period.82 In concluding that the payments made in exchange for relinquishing tenure were subject to employment taxes, the Sixth Circuit emphasized that “a court must not look simply at what is being relinquished at the point a severance payment is offered, but rather, how the right relinquished was earned. Thus, we cannot underestimate the importance of the fact that a teacher earns tenure by successfully completing a probationary period.”83 The court further emphasized that in its view, the tenure involved was earned by service to the employer and that it could not justify distinguishing payments for the relinquishment of tenure from payments for the relinquishment of seniority rights, litigation rights, and the like, which courts had previously subjected to employment taxes.84 To distinguish NDSU, the court pointed out that even though length of service was a factor in that case, the tenure rights arose from a single contract entered into at the commencement of the tenure relationship.85

C. University of Pittsburgh v. United States (2007)

As was noted previously, the facts surrounding the University of Pittsburgh decision are highly analogous to those in NDSU. Given that the Third Circuit formally rejected the Eighth Circuit’s approach, we now have a direct inter-Circuit conflict. Concluding that the early retirement program payments were, in fact, subject to FICA taxes, the Third Circuit reasoned that

79. Id. at 605-06.
80. 450 F.3d 185 (6th Cir. 2006).
81. Id. at 187.
82. Id.
83. Id. at 192.
84. Id. at 195.
85. Id. at 195 n.5.
the program’s years-of-service-based eligibility requirements linked the payments to prior service and not the relinquishment of tenure.86 Further, the court noted that retirement program descriptions clarified the reward-for-service nature of the payments and that even if the payments partially compensated recipients for the relinquishment of tenure rights, the primary payment purpose was to provide for early retirement, making the money “indistinguishable from severance payments, which are generally taxed as wages.”87 Although the court in NDSU found the selective and discretionary awarding of university tenure significant, the Third Circuit discounted that reality, reasoning that such factors “do not change the fact that [tenure] is awarded based on service to the University.”88

Though couched, to some extent, in terms indicating a different view of tenure, the Third Circuit’s mindset differs from that of the Eighth Circuit largely in its steadfast adherence to an apparent mandate from a prior case, Social Security Board v. Nierotko.89 Notwithstanding the fact that Nierotko was a benefits eligibility case, the Third Circuit perceived through it a mandate to construe “services” and “employment” (and thus “wages”) broadly. Accordingly, the majority concluded that early retirement payments made to tenured university faculty members constituted “wages” subject to FICA taxation.90 The bench did not, however, speak with a single voice.

In dissent, Chief Judge Scirica largely emphasized the fact that the grant of tenure requires the consideration of a host of factors and reflects a university’s conclusion with respect to many of the faculty member’s capacities, not the mere completion of a probationary period.91 It was further noted that the commencement of tenure marks a new and distinct relationship between the professor and the university.92 Accordingly, Judge Scirica agreed with the approach taken in NDSU and would have ruled in favor of the university.93

86. Univ. of Pittsburgh v. United States, 507 F.3d 165, 171-72 (3d Cir. 2007).
87. Id. at 172.
88. Id. at 174.
89. 327 U.S. 358 (1946). In Nierotko, the U.S. Supreme Court indicated that, with the purpose of the Social Security Act in mind, “service” can mean more than merely productive activity and can encompass “the entire employer-employee relationship for which compensation is paid to the employee by the employer.” Id. at 365-66.
90. Univ. of Pittsburgh, 507 F.3d at 175.
91. See id. at 177 (Scirica, C.J., dissenting).
92. Id.
93. Id. at 178.
D. Internal Revenue Service: Official Reactions and Shifting Perspectives

The IRS has not sat comfortably on the sidelines while the United States has taken the battlefield. In the wake of NDSU, the Service had no choice but to signal its intent to fight by issuing a prompt non-acquiescence.94 Given the weight of NDSU as binding precedent in the Eighth Circuit, however, the Service issued an Action on Decision (“AOD”) to clarify its intent to defer to the NDSU holding in cases appealable to the Eighth Circuit but to litigate cases otherwise.95 Years later, of course, the Service made a more widespread and candid announcement of its nationwide litigation intent in Revenue Ruling 2004-110.96 Technically, the 2004 Revenue Ruling conflicted with the Service’s prior AOD with respect to certain cases appealable to the Eighth Circuit. To the extent the Service intended to litigate cases appealable to the Eighth Circuit after the issuance of Revenue Ruling 2004-110, it should have overtly clarified its position with a new AOD concurrent with the issuance of that Revenue Ruling in 2004. The Service did not grow those new teeth, however, until after the government scored a Circuit-level victory in Appoloni v. United States97 in 2006. With a victory in Appoloni, the Service issued AOD 2007-01, thereby clarifying that, consistent with its policy outside the Eighth Circuit and Revenue Ruling 2004-110, it would challenge cases appealable to the Eighth Circuit even if they shared factual parity with NDSU to the extent payments were made on or after January 12, 2005.98 These developments present no real surprise. What is analytically jarring, however, is the fact that we are able to see the Service’s conception of “wages” shift in broad daylight from rationally narrow to aggressively broad over the course of a few decades.

95. N.D. State Univ. v. United States, 255 F.3d 599 (8th Cir. 2001), action on dec., 2001-08 (Dec. 31, 2001) (“Although we disagree with the decision of the court, we recognize the precedential effect of the decision to cases appealable to the Eighth Circuit, and therefore will follow it within that circuit only with respect to cases that have the exact facts as this case; that is, cases involving payments to college or university professors made in exchange for the relinquishment of their tenure rights. We will continue to litigate our position in cases having different facts in the Eighth Circuit, and in all cases in other circuits.”).
97. 450 F.3d 185 (6th Cir. 2006).
98. N.D. State Univ. v. United States, 255 F.3d 599 (8th Cir. 2001), action on dec., 2007-01 (Jan. 19, 2007). Ostensibly, the Service issued the new Action on Decision to “reflect the change in its published rulings.” Id. Given that Revenue Ruling 2004-110 was issued three years earlier, however, it seems more likely that the Sixth Circuit’s decision in Appoloni (decided June 7, 2006) prompted the new pronouncement.
In Revenue Ruling 55-520, an individual originally accepted employment under a two-year contract. During the second year, the employer requested and received the employee’s resignation. The employee’s resignation was conditioned, however, on the payment of amounts due for the remaining contract period. The company ultimately paid a lump sum, and the employees signed a general release. Regarding the tax issues presented, the Service concluded that the money paid as compensation for the early termination of the employment contract did not constitute “wages” for services performed for federal employment tax and income tax withholding purposes but did constitute gross income for basic federal income tax purposes. The Service reached the same conclusion just a few years later in Revenue Ruling 58-301. However, intervening and scantily-reasoned

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100. Id.
101. Id.
102. Id. at 394.
103. Id. (determining that although the individual owed taxes with respect to the amounts received, the employer was not legally obligated to withhold those taxes as the amounts received did not constitute “wages”); see I.R.C. § 3403 (2006) (requiring that employers who erroneously fail to withhold payroll or basic income taxes become liable for those taxes).
104. Rev. Rul. 58-301, 1958-1 C.B. 23 (noting, as well, that the employee’s contract right was not a capital asset and that any amounts received with respect to the relinquishment of that right constituted ordinary income and not capital gain). The U.S. Supreme Court also spoke to the income character issue. In Commissioner v. P.G. Lake, Inc., 356 U.S. 260, 265 (1958), Justice Douglas noted, “The lump sum consideration seems essentially a substitute for what would otherwise be received at a future time as ordinary income.” Accordingly, the Court held that a lump sum payment with respect to future income is ordinary income and not capital gain. Id. at 268; see also Comm’r v. Gillette Motor Transp., Inc., 364 U.S. 130 (1960) (holding, in a case involving payment for the involuntary use of the taxpayer’s property in the war effort, that not every property right is a capital asset); Rothstein v. Comm’r, 90 T.C. 488, 497 (1988) (holding that amounts received pursuant to an employment contract after the disposition of substantially all of the assets of a business constituted ordinary income (deferred compensation for services) and not capital gain because the employees did not hold an equity interest in the company).
developments aside, we see a complete about face in the aforementioned Revenue Ruling 2004-110.

In Revenue Ruling 2004-110, the Service concluded that payments made to an employee as consideration for early contract cancellation (when the contract was silent on the issue of early termination payments) were “wages” subject to FICA taxation. Adopting a decidedly Nierotko tone, the Service reasoned that “[e]mployment encompasses the establishment, maintenance, Furthermore, alteration, or cancellation of the employer-employee relationship or any of the terms and conditions thereof.” So, if the IRS of 2004 is to be believed, the IRS of 1955 simply got it wrong. Either that or the notion of “wages” has somehow managed to broaden gradually such that the same type of terminal payment which would ordinarily fall outside its ambit now comfortably falls within it. Far more likely is the reality that the Service has grown much more comfortable indulging its own tax-producing presumptions.

105. In Revenue Ruling 74-252, 1974-1 C.B. 287, the parties entered into a three-year contract which provided that the employer could terminate the contract early if the employee was paid an amount equal to six months of salary above and beyond any previously earned salary. Having restated general definitions of “wages,” the Service appealed to Treasury Regulations promulgated under §§ 3121 and 3306 of the Code, emphasizing that the term “wages” includes remuneration for employment made when the individual is no longer an employee. Id. But that wasn’t enough. The Service proceeded to reference Treasury Regulations from the income tax withholding arena that directly addressed the question of dismissal payments. Acknowledging that similar regulations did not exist in the employment tax context, the Service nonetheless concluded that FICA and FUTA taxes applied to the dismissal payments. See id. The Service makes a feeble effort to distinguish Revenue Ruling 58-301. Given that (in the current ruling) the payments “were made pursuant to the provisions of the contract rather than as consideration for the relinquishment of interests the employee had in his employment contract in the nature of property,” the Service concluded that the payments constituted wages. Id. Thus, “waige” characterization somehow turned on the existence or non-existence of an early termination contract clause rather than on a focused analysis of whether remuneration was, in fact, paid for services rendered. See id.; see generally Rev. Rul. 75-44, 1975-1 C.B. 15 (holding that a lump sum paid to a railroad employee constituted wages for federal income tax withholding purposes because the amount compensated the employee for relinquishing seniority rights acquired through prior service rather than compensating him for waiving any employment contract rights acquired via original negotiation).

107. Id.
108. Id. Despite the disparaging tenor of the ruling, the Service does note that, per § 7805(b), it will not apply the position set forth in the ruling to payments made by an employer to an employee or former employee before January 12, 2005, so long as the payments were made under facts and circumstances substantially similar to those in Revenue Ruling 55-520 or Revenue Ruling 58-301.
109. See Dilley, supra note 18, at 67 (“Earnings or wages cannot be distinguished from any other type of income except by the circumstances of receipt. The tax system frequently functions based on presumptions and circumstantial evidence that indicate the existence of one type of income or another, rather in the way astronomers detect black holes in space by noting the absence of other stars around them. For example, capital gains exist only in the context of a sale or exchange, just as compensation for services
The IRS surprises no one in gleefully siding with any court willing to fly the Nierotko flag, but tax equity demands consistency, which certainly does not take the form of contrasting judicial treatments of similarly-situated taxpayers complying with the same statute. The slipperiness of the “wages” concept makes this level of uncertainty possible, and more than one court has struggled to grab hold. The word “wages” certainly appears in many statutory contexts, and when there exists some apparently-rational link between the relevant statutes, logic suggests that the same word enjoys a consistent meaning across them. As the courts and Congress have made clear, however, such is not always appropriate.

Part IV of this Article first undertakes a basic examination of Nierotko, the decision regularly summoned by the Third Circuit and others, before reconciling it with United States v. Cleveland Indians Baseball Co.,110 which launches no assault on Nierotko’s logic but rationally counsels against an appeal to it in the tax arena (or, by extension, any arena outside the benefits eligibility context). The wisdom of that approach has already manifested itself; at least one court has found itself struggling to harmonize legitimate Congressional action with expansionist interpretations of Nierotko.

IV. COMMENTARY AND ANALYSIS

A. Nierotko and the Apparent Broad Construction Mandate

As the facts would have it, Joseph Nierotko’s original gripe was not with the Social Security Board.111 Rather, it was with Ford Motor Company, which wrongfully discharged him for engaging in union activity.112 For this transgression, the National Labor Relations Board not only ordered Ford to reinstate Nierotko, but also awarded him back pay.113 Although Nierotko wanted this back pay to constitute “wages” for his Old Age and Survivor’s Insurance account, the Social Security Board formally refused to credit the back pay as “wages”114 and thereby prompted the litigation. The U.S. Supreme Court held that the back pay constituted “wages”115 and that the relevant

111. Id.
112. Id.
113. Id.
114. Id. at 360.
115. Id. at 370.
amounts were to be allocated to the periods in which they would have been earned and paid over to Nierotko.116 Sensitive to the link between earning “wages” over time and qualifying for Social Security program benefits, the Court emphasized that individuals receiving back pay for periods during which they were wrongfully separated from employment were entitled to have the award treated as wages for purposes of the Social Security Act.117 Over the objection of the Social Security Board that no services were, in fact, performed during the wrongful discharge period,118 the Court stated the following:

The [Social Security Board] urges that Nierotko did not perform any service. It points out that Congress in considering the Social Security Act thought of benefits as related to “wages earned” for “work done.” We are unable, however, to follow the Social Security Board in such a limited circumscription of the word “service.” The very words “any service . . . performed . . . for his employer,” with the purpose of the Social Security Act in mind import breadth of coverage. They admonish us against holding that “service” can be only productive activity. We think that “service” as used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer.119

The Third Circuit and other courts have repeatedly turned to this language from Nierotko for support.120 All too commonly, however, they either choose to ignore the directive that the broad construction be embraced “with the purpose of the Social Security Act in mind”121 or proceed to draw in any legislation with a possible link to the Social Security Act.

116. Id.
117. Id. at 364.
118. Id. at 365.
119. Id. at 365-66 (citations omitted) (emphasis added). The Court also pointed out that both Social Security Board Regulations and Treasury Regulations treated vacation allowances, among other things, as “wages.” See id. at 365-66 & n.17.
120. See, e.g., Assoc. Elec. Coop. v. United States, 226 F.3d 1322, 1327 (Fed. Cir. 2000) (rejecting the argument that a broad reading of Nierotko reads the service performance requirement out of § 3121(b) by noting that “[p]ayments for hard work and faithful service arise directly from the employer-employee relationship and are payments which recognize the value or character of the services performed for the employer”); Cohen v. United States, 63 F. Supp. 2d 1131, 1135 (C.D. Cal. 1999) (relying on the broad sweep “dictated” by Nierotko and thereby concluding that “[b]ecause the payments are based on the plaintiff’s lengthy service to his employer, the payments can be considered compensation arising out of the employment relationship”).
121. See Nierotko, 327 U.S. at 365.

The U.S. Supreme Court’s decision in Cleveland Indians drew a much-needed and critically important line of demarcation by severing the concept of “wages” in the Social Security benefits context from the “wages” concept in the entire tax arena, thereby frowning on any attempt to rely on Nierotko, a benefits case, to characterize a given payment as “wages” for tax purposes.

Per settlement agreement with the Major League Baseball Players Association, the Cleveland Indians Baseball Company (“Company”) agreed to pay back wages to eight players (asserting salary damage claims relating to their free agency rights). Though allocable to 1986 and 1987, the damages were paid by the Company in 1994. The parties stipulated that the back pay constituted “wages” within the meaning of FICA and FUTA but differed with respect to the year in which the amounts were subject to tax. Relying on the prior period allocation rule dictated by Nierotko with respect to Social Security benefits determinations, the Company reasoned that the back pay awards should be allocated to 1986 and 1987 and, therefore, subject to FICA and FUTA taxation in accord with tax rates and wage base limits prevailing in 1986 and 1987 (a result that, generally, would not give rise to additional tax liability under the prevailing facts and circumstances). The Government countered that such amounts were actually paid in 1994 and, per longstanding interpretive regulations, should be taxed in accord with rates and wage base limits in effect in 1994.

The Government first argued that the FICA and FUTA statutes, on their face, apply to “wages paid during a calendar year.” The Court, showing due regard to its precedent, deemed the plain language argument unpersuasive. In Nierotko, the Court required the allocation of a current payment of back wages to the prior periods in which the wages should have been paid, despite the fact that the governing statute referred specifically to “wages” “paid” “in” “a calendar quarter.” Thus, the Court concluded that the plain language of

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123. See id.
124. See id. at 205.
125. See id. at 212.
126. See id. at 206.
127. See id. at 209-10.
128. See id. at 209.
129. See id. at 211-12.
130. See id. at 211.
the statute was not dispositive. And yet, in a matter of sentences, we see that the Court refused to import Nierotko’s back pay allocation mandate:

Because Nierotko read the 1939 “wages paid” language for benefits eligibility purposes to accommodate an allocation-back rule for backpay, the Company urges, the identical 1939 “wages paid” language for tax purposes must be read the same way. We do not agree that the latter follows from the former like the night, the day. Nierotko dealt specifically and only with Social Security benefits eligibility, not with taxation. . . . Nierotko thus does not compel symmetrical construction of the “wages paid” language in the discrete taxation and benefits eligibility contexts.

Putting “paid” aside, the Court affirmatively clarified the notion that “wages” need not mean the same thing in the discrete taxation and benefits contexts. In rejecting the argument that Congress changed language in the FICA and FUTA tax provisions to incorporate, albeit indirectly, Nierotko’s backpay allocation rule, the Court emphasized that Congress amended the tax provision to ensure that “wages” were measured in both the tax and benefits eligibility contexts based on “the amount paid during the calendar year,” not, as the company would have it, to incorporate Nierotko’s backpay allocation rule.

Thus, the Court noted clear Congressional intent with respect to a consistent time period for the measurement of “wages.” The Court then stated the following:

Because the concern that animates Nierotko’s treatment of backpay in the benefits context has no relevance to the tax side . . . it makes no sense to attribute to Congress a desire for conformity not only with respect to the general rule for measuring “wages,” but also with respect to Nierotko’s backpay exception.

So, given that the Nierotko Court itself dictated that its conception of “wages” be understood with the purposes of the Social Security Act in mind, the Cleveland Indians Court rightly dug a deeper trench between the land of benefits and the land of tax in asserting that one cannot attribute to Congress an intent either to impose a uniform back pay allocation scheme or to require that the “wages” (which, in any event, must be ascertained on a calendar year basis) actually be measured substantively in precisely the same way. Bear in mind that Joseph Nierotko filed suit against the Social Security Board, not the
Commissioner of Internal Revenue and not (for a refund) against the United States. The *Cleveland Indians* decision contains a valuable directive, and language from the face of precedent should be featured prominently in any future efforts to secure the issuance of a writ of certiorari on this issue. Although it is true that the parties in the case stipulated that "wages" were at hand, the justices had ample cause and opportunity to weigh in. In his concurrence, Justice Scalia momentarily sidestepped litigant stipulations and hammered the definitional issue squarely on the head:

In fact, I do not think that the text of the FICA and FUTA provisions . . . addresses the issue we face today. Those provisions, which direct that taxes shall be assessed against "wages paid" during the calendar year, would be controlling if the income we had before us were "wages" within the normal meaning of that term; but it is not. The question we face is whether damages awards compensating an employee for lost wages should be regarded for tax purposes as wages paid when the award is received, or rather as wages paid when they would have been paid but for the employer's unlawful actions. . . . The proper treatment of such damage awards is an issue the statute does not address . . . .

Thus, Justice Scalia unambiguously opined that back pay damage awards are not, in fact, "wages" in the traditional sense and ultimately shifted the question to one of mere timing. He continued on to confirm what he saw as the propriety of currently taxing the Company in light of the fact that the proper treatment of the amounts paid is not addressed by the statute and thus "left to the reasonable resolution of the administering agency, here the Internal Revenue Service." That approach, however, simply signs a court up to fly the *Nierotko* flag, and the majority opinion counsels against that approach in the tax arena. Unfortunately, that widespread tendency will occasionally put a court in the awkward position of needlessly trying to reconcile federal tax laws with non-tax authority. This is precisely what happened in *CSX Corp. v. United States* (“CSX”).

137. *Id.* at 221 (Scalia, J., concurring).
138. *Id.*
139. *Id.* Other U.S. Supreme Court justices (e.g., Justice Rehnquist in his dissent in *Bob Jones University*) have been known to resist such deference, affirmatively rejecting administrative agency interpretations, including those of the IRS, despite overwhelming consistency of the interpretation with prevailing public policy. *See* *Bob Jones Univ. v. United States*, 461 U.S. 574, 620-23 (1983) (Rehnquist, J., dissenting).
140. *See Cleveland Indians*, 532 U.S. at 212.
141. 52 Fed. Cl. 208 (Fed. Cl. 2002).
C. CSX Corp. v. United States (2002)

The court in CSX addressed issues concerning the taxability of supplemental unemployment compensation benefits paid to employees suffering an involuntary separation from work.\(^{142}\) The court ultimately held (with respect to some workers) that the payments were not subject to FICA taxes largely because, as laid-off employees performed no services, the workers had suffered the requisite “separation from employment.”\(^{143}\) Rejecting the government’s assertion that the benefits did, in fact, constitute “wages,” the court appealed to legislative history.\(^{144}\) By enacting § 3402(o), noted the court, Congress overtly required withholding with respect to what it did not regard as “wages,” largely to head off any potential problems with respect to payment of the resulting income tax liability.\(^{145}\) The court emphasized that “payments that are non-wage payments from the start are beyond FICA taxation as much as they are beyond income-tax withholding. The taxation of such payments requires their specific inclusion in the taxing scheme.”\(^{146}\)

In the court’s view, “wages” need not necessarily mean the same thing in the income tax and FICA tax arenas, but in the absence of an express exclusion from gross income or express exclusion from FICA taxation, there is no basis for distinguishing the meaning of “wages” in one context as opposed to the other.\(^{147}\) Given the parity of the concepts in the court’s view and Congress’s explicit inclusion of a given amount in “wages” for income tax withholding purposes (per § 3402(o)), the court felt the need to explain § 3402(o) as an exception to Nierotko:

In reaching this conclusion, we remain mindful of the Supreme Court’s reading of the words “any service” in the Social Security Act’s definition of employment: “‘service’ . . . means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer.” While these words are certainly expansive enough to sweep into the employment relationship any payment made by an employer on account of an employee—hence making any such payment a wage—nevertheless, § 3402(o) payments must be regarded as an exception to this broad pronouncement.\(^{148}\)

\(^{142}\) See id. at 209-10.
\(^{143}\) See id. at 218-19; see also 26 U.S.C. § 3402(o)(2)(A).
\(^{145}\) See CSX, 52 Fed. Cl. at 211.
\(^{146}\) Id. at 215.
\(^{147}\) Id. at 213.
\(^{148}\) Id. at 218 (citations omitted).
Put differently, if one believes and applies Nierotko, one does not need § 3402(o) to mandate withholding. But, apparently, Congress did not see the amount as “wages” because it felt compelled to impose a new withholding obligation. With Nierotko rightly confined to the Social Security benefits context, this court would not have felt the need to hem and haw its way around Nierotko to justify Congressional legislation; it could have easily dismissed any expansionist Nierotko-based arguments with the firm support of Cleveland Indians (i.e., urging the confinement of Nierotko’s broad notions to the Social Security benefits eligibility context). Further, the court misses a golden opportunity. Rather than explaining § 3402(o) as an exception to Nierotko’s apparent mandate, the court could have clarified that the income tax withholding concept of “wages” is, in fact, narrower than the benefits eligibility concept (as § 3402 confirms) and that some courts incline toward overstating Nierotko’s legendary prowess. Over time, both Nierotko and Nierotko-like notions (in the tax arena) will seek out new revenue territory as the American population ages and the need to secure employment tax revenue intensifies. Payments on the periphery of (or arguably outside) the employment relationship (e.g., settlement damages, severance, etc.) make easy targets, but such taxing excesses give rise to fairness and other issues both in the tax system and the Social Security system.

D. Death Tax on the Employment Relationship and Social Security Double Dipping

Attempting to tax terminal non-wage payments, whether achieved intentionally or inadvertently, is effectively attempting to tax or succeeding in taxing the employment relationship itself simply because it used to exist. Hasn’t Congress already panned that shiny nugget? Inasmuch as § 3101 works its taxing magic on employees with respect to “wages” received with respect to “employment,” Congress already imposes on every employer, per § 3111, “an excise tax, with respect to having individuals in his employ.” 150 So, the appropriate excise taxes are collected over the years during the working relationship. To collect more from the employer and the employee at the bitter end arguably amounts to a death tax on the employment relationship. As we

150. This 6.2% tax simply represents the employer’s portion of the OASDI tax. See 26 U.S.C. § 3111(a) (2007). For the provision imposing the employer’s portion of the Medicare tax, see § 3111(b).
have it currently, and despite the lessons of Cleveland Indians, various courts have become far too comfortable with easy piggybacking off of the employment relationship.

Further, taxing a given amount as current year “wages” (even though such amounts relate to prior periods) presents a potential double-dipping problem on the Social Security side of the equation. By insisting that back wages paid during a given year be taxed, per Treasury Regulations, in the year paid (and not allocated to the prior period), the Service might well allow a taxpayer to receive four quarters of Social Security benefits eligibility credit in a given year (assuming the individual earns a sufficient dollar amount) and four more quarters for earnings related to the same prior period when back wages are paid in a later period, especially when the annual four-quarters-over-credit threshold is low (e.g., $4,200). The Social Security Administration would consider such a result inappropriate under federal law dictating that an individual receive no more than four quarter credits for a given year of work. The same double dipping problem arises in the tenure relinquishment context, as well as in any context in which the government’s current-additional-payment-for-prior-services-rendered argument manages to get traction. To the extent the United States was willing to take the payroll taxes and deny quarters of coverage credit on the Social Security eligibility side of the equation, it did not clarify this position in Cleveland Indians.

V. SEARCH FOR THE MEANING OF “WAGES”

The preceding discussion shows how the misapplication or misinterpretation of U.S. Supreme Court precedent over time can lead to awkward judicial “justification” or “explanation” of legitimate Congressional activity. Further, that discussion enables one to see how differing

151. As for proper timing, the Treasury Regulations clarify that wages are generally considered “received” by an employee whenever the amounts are paid. See Treas. Reg. § 31.3121(a)-2(a) (2008). The payment may be actual or constructive. See id. Payment timing will, of course, have tangible repercussions. From a tax perspective, the timing of a given wage payment may result in the imposition of a different rate of tax (to the extent OASDI rates do not remain static), and given the gradual rise of the FICA Wage Base, timing may well alter the amount of the wages subject to tax (or, if the taxpayer is lucky, result in the allocation of wages to years in which the taxpayer has already paid the maximum FICA tax liability). From a Social Security perspective, the timing of wage payments may prove equally critical, given that an individual’s basic eligibility for various benefits under the broader program scheme turns, at least in part, on working in a qualifying position for a requisite minimum time period. See sources cited supra note 27.

interpretations of the meaning of “wages” in highly analogous factual contexts can give rise to disparate and, arguably, inappropriate results in individual cases. Given the mammoth day-to-day, paycheck-to-paycheck significance of the “wages” concept, the absence of definitional clarity is lamentable, especially in light of the fact that the ramifications of ambiguity are potentially serious and far-reaching. Payroll taxes collected on employee “wages” not only fund both Social Security and Medicare programs but also provide revenue for general government expenditures. If changing U.S. demographics have already exerted expansive conceptual pressure on the “wages” concept, the problem may intensify in the short-term and get progressively worse as time goes on. When serving in the Senate, current President Barack Obama indicated his intent to alter FICA Wage Base parameters. Initially eschewing moderation, Obama proposed elimination of the wage cap altogether. That move would impose payroll taxes on 100% of wages earned, and, had it been done in 2008, would have raked an additional $122 billion into the system. Obama has since embraced the notion that those earning approximately $100,000 to $250,000 deserve a break. Thus, there is imminent and compelling need to bring a higher degree of definitional clarity to, at the very least, the payroll tax conception of “wages,” especially in light of the fact that as a regressive tax, the payroll tax “affects the poor and middle-class most heavily . . . .” Are “wages” in the Social Security benefit eligibility context the same as “wages” in the tax world? After all, each standing alone is a soaring statutory edifice (though one can scarcely ignore the link between the two). And even within the confines of the tax structure, are the “wages” subject to withholding for payroll tax purposes the same as the “wages” subject to withholding for general income tax purposes? Should they be? Are signing bonuses “wages” (for any purpose)

153. See Karen Tumulty, supra note 49 (highlighting the differing perspectives of Senators Hillary Clinton and Barack Obama with respect to the propriety of having a “FICA Wage Base”).
154. Those with $1 million in earnings would pay an additional $55,676. Id.
155. See id. Senator Clinton pled for the need for a commission to study the problem but otherwise lamented that uncapping the FICA Wage Base is “a $1 trillion tax increase” that the country does not need. See id. She did, however, consider shoring up the solvency of the Social Security Trust Fund among her chief goals should she have become president. See Kathy Kiely, Clinton: Asks to be judged on career in its entirety, USA TODAY, Dec. 31, 2007, at 7A.
156. See Andrew G. Biggs, Opinion, The Obama Tax Hike, WALL ST. J., Mar. 12, 2008, at A20 (noting that Senator Obama wants to “create a ‘donut hole’ in the taxing mechanism that pays for the nation’s largest retirement program”).
when paid well before an employee gets on the clock for the first day of work? And if so, what about payments collected at the end stage of an employment relationship when the individual has been off the clock for quite some time for reasons having nothing to do with the literal performance of services? The following discussion chronicles the judicial struggle to discern the many contours of the “wages” concept in its several contexts while, at the same time, tackling the question of whether existing doctrine allows a reasoned delineation of the meaning of “wages” in a given context or whether the solution is simply to resort to the sword of legislative or judicial fiat.

A. “Wages” Versus “Income” and the Free Lunch Skirmish

Most tax and non-tax professionals would readily confirm that not all “income” takes the form of “wages.” Lottery and game show winnings are enjoyable examples to contemplate. But, can an employer ever pay an employee an amount which qualifies as “income” but, nonetheless, does not constitute a “wage”? The U.S. Supreme Court answered that question in the affirmative in *Central Illinois Public Service Co. v. United States* [158] (“Central Illinois”). In doing so, the Court provided useful guidance concerning the proper scope of “wages” generally and a rather saucy clarification of the difference between “wages” and “income.”

In *Central Illinois*, the company/employer reimbursed the lunch expenses of employees working offsite who, nonetheless, were not on jobs requiring that they stay overnight. [159] The employer failed to withhold federal income taxes with respect to these lunch payments, and accordingly the Service took issue. [160] Although the district court ruled in favor of the company, the United States Court of Appeals for the Seventh Circuit reversed. [161] To resolve the freshly-created conflict between the Fourth and Seventh Circuits [162] on the issue, the U.S. Supreme Court granted certiorari. [163]

Under the opinion of Justice Blackmun, the Supreme Court reversed. [164] The Court noted, “[T]he two concepts—income and wages—obviously are not necessarily the same. Wages usually are income, but many items qualify as

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159. See id. at 22.
160. See id. at 22-23.
161. See id. at 24.
164. See id. at 33.
income and yet clearly are not wages. Interest, rent, and dividends are ready examples."\textsuperscript{165} To this, the Government argued that the word “wages” in § 3401 (governing withholding of income tax from wages) corresponds readily with the word “wages” in § 61(a)(1) (defining gross income) and “that the two statutes ‘although not entirely congruent . . .’ have ‘equivalent scope’ . . . .\textsuperscript{166} The government further contended that the payments were compensatory because they were paid for services rendered, that there was a direct causal link between the payment and the services, and that the payment was part of a total remuneration package.\textsuperscript{167} After citing various authorities in support of a broad reading of the word “wages” in tax statutes generally,\textsuperscript{168} the government ultimately “urge[d] that what is important is that the payments at issue were a result of the employment relationship and were part of the total of the personal benefits that arose out of that relationship.”\textsuperscript{169} Justice Blackmun refuted that argument and, one could argue, chastised the government for putting it forth:

“We do not agree with this rather facile conclusion advanced by the Government. The case, of course, would flow in the Government’s favor if the mere fact that the reimbursements were made in the context of the employer-employee relationship were to govern the withholding tax result. That they were so paid is obvious. But it is one thing to say that the reimbursements constitute income to the employees for income tax purposes, and it is quite another thing to say that it follows therefrom that the reimbursements in 1963 were subject to withholding. There is a gap between the premise and the conclusion[,] and it is a wide one.\textsuperscript{170}

Well aware of the fact that employers are liable for employee taxes that should have been withheld but were not,\textsuperscript{171} the court emphasized the impropriety of forcing an employer to carry the risk of his employee’s tax liability and the relatively narrow scope of income subject to employer withholding.\textsuperscript{172} After noting repeated instances of courts distinguishing “wages” and “income” and refusing to equate the two, the Court commented on the fundamental

\textsuperscript{165} Id. at 25 (citations omitted).
\textsuperscript{166} Id. at 28.
\textsuperscript{167} See id.
\textsuperscript{168} See id. at 28-29.
\textsuperscript{169} Id. at 29.
\textsuperscript{170} Id.
\textsuperscript{171} See id. at 31.
\textsuperscript{172} Id. (“To require the employee to carry the risk of his own tax liability is not the same as to require the employer to carry the risk of the tax liability of its employee. [Income subject to] [r]equired withholding, therefore, is rightly much narrower [in scope] than [income subject] to income taxation.” (emphasis added)).
importance of rationally confining the meaning of “wages” and the need to steer clear of any unwarranted expansionist constructions:

An expansive and sweeping definition of wages . . . is not consistent with the existing withholding system. As noted above, Congress chose simplicity, ease of administration, and confinement to wages as the standard in 1942. This was a standard that was intentionally narrow and precise. It has not been changed by Congress since 1942, although, of course, as is often the case, administrative and other pressures seek to soften and stretch the definition. Because the employer is in a secondary position as to liability for any tax of the employee, it is a matter of obvious concern that, absent further specific congressional action, the employer’s obligation to withhold be precise and not speculative. 173

So, with Central Illinois, the Supreme Court issued a stern reminder that not all “income” constitutes “wages” and that the “wages” concept is “narrow and precise” and not to be softened and stretched as an administrative palliative or as an analytical relief valve for “other pressures.” But just how wide or narrow is the “wage” concept? Can one ever characterize an amount as “wages” for general income tax withholding purposes but somehow—aside from imposing a fixed statutory dollar cap like the FICA Wage Base—justify deeming the amount not to constitute “wages” for payroll tax purposes? The Supreme Court deemed a single “wage” concept to be broad enough to encompass both the income tax and payroll tax withholding. Congress, however, felt it necessary to sever what the Court conceptually sutured for the sake of administrative simplicity and ease.

B. Income Tax Conception of “Wages” Versus Payroll Tax Conception of “Wages”

In Rowan Companies v. United States, 174 the taxpayer provided meals and lodging to its employees working on offshore oil rigs as a cost-effective alternative to transporting them to and from shore for each shift. 175 The taxpayer excluded the value of the meals and lodging from employee “wages”

173. Id. (emphasis added).
175. See Rowan Cos., 452 U.S. at 248.
for federal income tax withholding purposes, as well as from “wages” for employment tax withholding purposes.\textsuperscript{176} Though the IRS did not object to the wage exclusion with respect to federal income taxes, the Service argued, consistent with governing Treasury Regulations, that the value of the meals and lodging should have been included in “wages” for employment tax withholding purposes.\textsuperscript{177} Justice Powell and several of his brethren\textsuperscript{178} disagreed.\textsuperscript{179} Citing relevant legislative history with respect to federal statutes authorizing FICA, FUTA, and income tax withholding,\textsuperscript{180} the Court emphasized that Congress intended to coordinate income tax and payroll tax withholding and would not have used substantially identical definitions to refer to different concepts.\textsuperscript{181}

Thus, in the eyes of the Court, a wage exclusion for income tax withholding purposes would generally result in an identical exclusion for payroll tax purposes. To the IRS, this result was unbearably good news for the taxpayer. Arguing that FICA and FUTA “compose a distinct system of taxation to which the rules of income taxation . . . do not apply,”\textsuperscript{182} the Government complained that “Congress intended to impose the taxes under FICA and FUTA upon a broad range of remuneration in order to accomplish the [Social Security] Act’s purposes.”\textsuperscript{183} To support this position, the Government noted that in the legislative history of the Social Security Act, Congress made it clear that the term “wages” for employment tax purposes was to include cash as well as non-cash compensation, including room and board (items that might well have qualified for exclusion from wages for income tax purposes).\textsuperscript{184} Flatly rejecting the notion of a categorically broad construction of “wages” in the FICA and FUTA context, the Court reasoned that nothing in the legislative history of the Social Security Act (including the specific reference to “room and board”) “mean[t] that Congress intended to

\begin{footnotesize}
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\item\textsuperscript{176} See id. at 249.
\item\textsuperscript{177} See id. at 249-50.
\item\textsuperscript{178} Justice Sandra Day O’Connor joined the Court several months after this case was decided. See http://en.wikipedia.org/wiki/Sandra_Day_O’Connor (last visited Aug. 17, 2008).
\item\textsuperscript{179} See Rowan Cos., 452 U.S. at 250.
\item\textsuperscript{180} See id. at 255-56.
\item\textsuperscript{181} Id. at 256-57 (“Congress intended . . . to coordinate the income-tax withholding system with FICA and FUTA. In both instances, Congress did so to promote simplicity and ease of administration. Contradictory interpretations of substantially identical definitions do not serve that interest. It would be extraordinary for a Congress pursuing this interest to intend, without ever saying so, for identical definitions to be interpreted differently.”).
\item\textsuperscript{182} Id. at 257.
\item\textsuperscript{183} Id.
\item\textsuperscript{184} See id.
\end{itemize}
\end{footnotesize}
tax remuneration in kind without regard to principles developed under income taxation, such as the convenience of the employer rule.”  

The Court also pointed out that including room and board in wages for employment tax purposes was in no way inconsistent with the convenience-of-the-employer rule because the items would constitute wages unless they had been provided for the convenience of the employer.

In response to the Court’s holding in Rowan Companies, Congress changed the law in the Social Security Amendments of 1983 to clarify that the existence of a wage exclusion in the income tax context need not carry over to the employment tax context unless Congress provides an explicit employment tax exclusion. Congress also emphasized, as a general matter, that “an employee’s ‘wages’ for Social Security tax purposes may be different from the employee’s ‘wages’ for income tax withholding purposes.”  

Thus, at least from 1983 forward, we have formal segregation of the employment tax conception of “wages” and the income tax withholding conception of “wages” per Congressional mandate. But just how concrete and discernible is that construct? Knowing that not all “wages” are “income” and that “income tax wages” need not equal “payroll tax wages” does not necessarily help one ascertain whether a given amount actually constitutes “wages” for a given purpose.

C. The Search for “Wages”

Despite the Supreme Court’s clear directive in Central Illinois to confine the concept of “wages,” some courts continue to attach the “wages” label to almost any form of payment flowing from employer (or former employer) to employee, even when the payment represents damages to compensate the employee for unlawful employer conduct. Commonly, they reach and

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185. Id. at 257-58.
186. See id. at 258 n.12.
187. See Senate Report, supra note 174, at 42.
188. See id.
191. See, e.g., Cohen v. United States, 63 F. Supp. 2d 1131 (C.D. Cal. 1999) (holding that post-resignation severance payments paid constituted “wages” subject to FICA taxation and that such payments were taxable in the individual years of receipt).
192. See, e.g., Mayberry v. United States, 151 F.3d 855 (8th Cir. 1998) (concluding that ERISA
explain these results by pairing what they consider key factors with Nierotko’s apparent mandate for the broadest possible conception of the employer/employee relationship. The following discussion presents and critiques specific factors previously found to be determinative or, at least, highly persuasive by some courts. The judicial struggle to find truly firm footing is not a pretty sight.

1. Consideration of Eligibility Factors

   In their efforts to ascertain whether a given payment constitutes “wages,” some courts reason that “eligibility requirements provide the most accurate test to determine whether a payment is truly in consideration for services rendered.” Thus, in Sheet Metal Workers Local 141 Supplemental Unemployment Benefit Trust Fund v. United States, the court held that certain payments made to union members constituted “wages” because eligibility for receipt of a payment turned on past or present employment by a contributing employer/contractor. Likewise, the court in Cohen v. United States concluded that post-resignation severance payments constituted “wages” subject to FICA taxation after pointing out that the determination of “wage” status turned on both payment eligibility requirements and the method by which the payment amount was calculated. Relying on Nierotko’s prophylactic employer-employee relationship notions, the court concluded that “[b]ecause the payments are based on the plaintiff’s lengthy service to his employer, the payments can be considered compensation arising out of the employment relationship.”

   Facially, the eligibility approach has some appeal given that lengthy prior service requirements would certainly make it seem as though the amounts paid constitute compensation for services rendered. But eligibility factors standing alone prove little and reflect, in some instances, a degree of backward reasoning. Contested cases will routinely involve those who were, in fact,
eligible to receive the payment, so the choice of test itself introduces risk because that choice may plot the analytical course for a given result. Courts relying heavily on eligibility as a determinant fail to appreciate what one might call an “eligibility continuum,” in which eligibility parses very well at one end and very poorly at the other.

Consider, for example, the annual bonus a law firm associate might qualify for as a result of working (and billing!) 2,400 hours (as opposed to a mere 2,200 hours) in a given fiscal year. Surely in this context eligibility accurately identifies differing levels of service and effectively links additional compensation and the additional services rendered. The same result would appear appropriate if, in addition to working and billing 2,400 hours, the associate had to perform some ministerial act to secure final payment of the bonus. At the other end of the spectrum, we have situations in which, although eligibility is a basic threshold, the potential recipient must tender forth or surrender some form of consideration to trigger the prize. Here, mere eligibility loses considerable luster as a means of truly informing the character of post-eligibility consideration exchanges, since the link between the eligibility and the prize is attenuated (at best) or irrelevant (at worst). Thus, for example, a seventeen-year-old may gain admission to an R-rated movie without the accompaniment of a parent or adult guardian. That same seventeen-year-old, however, must pay the price of admission in order to see the feature presentation. Of course, the provision of mature entertainment is related in some sense to the time previously lived. In fact, one might go so far as to say that the individual has presumably gone through a maturation process and thus “earned” the right to see the movie. Yet, maturation can be a passive process, and arguably the rating agency simply assumes that the individual can understand or process the entertainment. But it is hard, in the end, to argue against the notion that the provision of the entertainment (the “prize”) is in exchange for the youngster’s $10, as opposed to being in exchange for his having lived seventeen years of life.

In the tenure relinquishment context, one can certainly argue that living seventy years of life establishes mere eligibility and that, for example, the rendering of seven pre-tenure (or thirty-three post-tenure) years of service to the university serves as consideration for the prize of payment (i.e., compensation for services previously rendered); the relinquishment of tenure merely serves as the necessary but ministerial act required to trigger payment. This approach presents several problems. As an initial matter, it makes little

sense to pay a substantial sum solely for pre-tenure years of service when the bulk of years served occurred post-tenure. Second, characterizing the payment as compensation for post-tenure (or all) years of service makes sense only if one can realistically argue that the relinquishing professor has willingly suffered underpayment during the employment period (i.e., he or she has salary in escrow) or that long-term university employment somehow triggers a new payment obligation with an *automatic* cash-out. After all, by analogy, once the teenager pays his $10, he has the right to see the movie. The tenure relinquishment context is simply not analogous. At the same time, the tenured professor must have something to surrender if the relinquishment payment is to avoid “elaborate gold watch” status and take on a character fully analogous to the teenager’s payment of the price of admission (i.e., an event having significance independent of the mere satisfying of transaction-entering eligibility requirements). What, then, does the tenured professor hand over at the “box office”/moment of retirement truth? He hands over the substantive and procedural protections protecting him as a tenured member of the faculty. And let’s not forget that he retires in fact.

Thus, in this context, eligibility ultimately fails as a reliable parsing concept because mere eligibility cannot rationally and consistently inform an analysis of related or subsequent transactions. To the extent that eligibility can serve as a proxy for anything in this context, it is an extremely poor proxy, and courts relying heavily on eligibility as a factor may well be veering hard for a given result. Certainly, there are some circumstances (e.g., bonuses) in which there is a clear link between service performance and benefit eligibility, and in the employment context at least, one might well find eligibility rationally linked with service performance more often than not. But the contemporaneous existence of the cart and the horse does not mean that they will end up hitched together.

2. Consideration of Damage Allocation

In addition to looking at eligibility requirements, courts also consider damage allocation in determining whether to treat a given amount as “wages” with respect to “employment.” At first glance, one might casually conclude that damage awards allocated to back pay surely constitute “wages.” After all, had the employee been paid the compensation in the ordinary course of business, the employer would have withheld both basic federal income taxes and employment taxes. Likewise, to the extent that the parties or courts allocate damages to other categories (e.g., personal injury caused by an
employer), “wage” characterization seems patently inappropriate. But rational and favorable allocation is no cake walk. Courts routinely put payees to the test, and plaintiffs may face harsh results if they cannot make the case for favorable damage allocation.

Arguably, allocation analysis turns out to be a pretty blunt instrument not well suited for the making of fine distinctions. Allocation of a given damage

200. See Dotson v. United States, 87 F.3d 682, 690 (5th Cir. 1996) (holding that ERISA-related settlement award amounts allocated to personal injury would not constitute “wages”).

201. See Associated Elec. Coop., Inc. v. United States, 226 F.3d 1322 (Fed. Cir. 2000) (holding that workers relinquished their right to strike for payments and other benefits granted by the agreements); see also Abrahamsen v. United States, 228 F.3d 1360 (Fed. Cir. 2000) (holding that severance-type payments made to former employees constituted wages for FICA purposes). In Abrahamsen, the court emphasized that the employees “failed to demonstrate that the payments were so closely related to such claims that they constituted settlement payments instead of severance payments made to compensate for the employer-employee relationship.” Id. at 1365.

202. See Donnel v. United States, 50 Fed. Cl. 375, 386-87 (2001) (concluding, in the absence of evidence allowing bifurcation, that a severance-type payment constituted “wages” for FICA purposes because the facts and circumstances indicated that the amount was paid primarily as a reward for prior service and not as consideration for a release of rights). One commentator agrees with this approach, at least under some circumstances, because in his view, releases are standard components of separation agreements and, unless such releases relate to a specific claim, courts should treat the entire severance payment as “wages” for FICA tax purposes. See Hirsch, supra note 190, at 820.

203. Given that § 3121(b) generally defines “employment” as “any service, of whatever nature, performed . . . by an employee for the person employing him . . . ,” some have argued that a broad reading of Nierotko (e.g., to cover remuneration for back pay, future pay, severance, and other items) effectively reads the “service” requirement out of the statute. See Associated Elec. Coop., 226 F.3d at 1326-27. Courts frequently reject this notion, some by seeing the payment as having its natural origin in the employment relationship and others by hypothecating. See id. (holding that severance and early-out payments constituted “wages” for employment tax purposes after noting that “[p]ayments for hard work and faithful service arise directly from the employer-employee relationship and are payments which recognize the value or character of the services performed for the employer”). The court in Gerbec v. United States reasoned that [h]ad Plaintiffs in this case actually worked . . . during the periods for which they sought back wages and future wages lost as a result of the firing, the wages indisputably would have been subject to FICA taxation. We conclude that it would be improper to exempt Plaintiffs from mandatory FICA taxes merely because they were not employees . . . at the time the payments were made and because the payments were not in return for actual services performed. Gerbec v. United States, 164 F.3d 1015, 1026 (6th Cir. 1999).

Putting criticism of hypothecation aside, the court’s logic works, at best, with respect to damage awards allocated specifically to back pay. By the forcing hand of litigation or settlement, the employer must tender forth what it should have tendered forth originally. Regarding future pay and damages for various forms of employer misconduct, the reasoning collapses: no worker gets on the clock to suffer discrimination or harassment, and future “pay,” viewed broadly, need not take the form of remuneration subject to income or payroll taxes. And even regarding damages allocated to back pay, it is Justice Scalia himself who challenges oft-prevailing notions to reveal the naked truth in Cleveland Indians: damages allocable to back pay are “damages,” not “wages” within the normal meaning of that term. See United States v. Cleveland Indians Baseball Co., 532 U.S. 200, 219 (2001) (Scalia, J., concurring) (deferring to longstanding IRS interpretations of governing statutes by holding that back wages are to be taxed (under FICA and FUTA)
amount to X simply means that an arbitrary decision has been made such that $Y in damages are deemed to compensate for X wrong. It remains true that well-reasoned allocations may make some sense, but the damage allocation science is woefully inexact, and final allocations likely reflect little more than the relative strength of the reasoning of the parties. Even at its best, however, reasoned allocation does not alter the character of what is truly at hand: damages awarded not as compensation for services but as compensation for a wrong suffered. It would be truly egregious to impose additional (payroll) taxes on an individual recovering amounts due to offensive harms suffered at the hands of her employer. Yet, an unfavorable allocation of damages (to include some compensatory component) has that result. Thus, a non-employee litigant suffering a given harm at the hands of a given company may, in fact, face a lower overall tax liability than a similarly-situated employee litigant suffering the same exact harm (or some harm that is equally illegal) at the hands of the same exact company. Such is the inevitable result when courts hurriedly sweep almost any money changing hands from master-employers to servant-employees into the shadow of “wages,” notwithstanding the existence of facts making it abundantly, if not patently, clear that the money was not tendered in exchange for services rendered. For example, in 1983, George Hemelt and others filed a class action against their former employer Continental Can Company under ERISA, claiming that the company discharged them so as to prevent them from receiving their pensions. 204 Although the parties ultimately settled their dispute, 205 Hemelt and various other class members sought to recover income and employment taxes withheld from their settlement payments. 206 Despite the existence of gross employer misconduct and the settlement of highly-specific claims for a sum certain, the court in Hemelt v. United States 207 was apparently blinded by the glare of the

204. See Hemelt v. United States, 122 F.3d 204, 206 (4th Cir. 1997).
205. See id. at 206.
206. See id.
207. 122 F.3d 204.
employer/employee relationship. In its view, “payments based on section 502(a)(3) [ERISA] claims, like claims under Title VII and the ADEA, are analogous to, and were designed to approximate, recovery for lost wages and other economic harms.”209 Thus, reasoned the court, “because the payments from Continental to taxpayers and other class members arose out of their employment relationship, they fit within the statutory and regulatory definition of wages . . . .”209 Fortunately, cooler heads will occasionally prevail. In Wilson v. AM General Corp.,210 the court held (in an age discrimination suit) that since the plaintiff performed no services for the employer with respect to lost back wages, lost future pension benefits, or lost front pay, the amounts awarded were not remuneration for employment and thus not “wages” subject to withholding.211 Thus, unlike others, the Wilson court appropriately kept Nierotko-based notions on a tight leash. Though acknowledging that Nierotko interpreted “services performed” broadly (so as to encompass the entire employer-employee relationship for which compensation is paid to the employee),212 Judge Miller noted that in Nierotko, the wrongfully-discharged individual remained, per Labor Act definitions, an “employee” during the period of inactivity, regardless of the fact that the employee was not rendering services to the employer.213 That fact pointed up a key distinction: that Mr. Wilson was effectively terminated, not reinstated, and not deemed a continuing employee.214

D. Can a Payroll Tax Conception of “Wages” Stand Alone?

As the preceding discussion demonstrates, separating the payroll tax conception of “wages” from the general income tax conception is difficult. The FICA Wage Base provides definitional fiat on the payroll tax side (i.e.,

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208. Id. at 209.
209. Id. at 210; see also Mayberry v. United States, 151 F.3d 855 (8th Cir. 1998) (concluding that ERISA settlement awards constituted “wages” for FICA purposes); Cohen v. United States, 63 F. Supp. 2d 1131 (C.D. Cal. 1999) (holding that post-resignation severance payments paid constituted “wages” subject to FICA taxation and that such payments were taxable in the individual years of receipt).
211. See id.
212. See id.
213. See id.
214. Id. at 1148 ("Like Nierotko, Mr. Wilson did no work for the monies at issue, but unlike in Nierotko, Mr. Wilson’s judgment is not compensation within even a broadly-defined employer-employee relationship. Mr. Wilson was not reinstated and did not remain AM General’s employee by operation of the ADEA or any other statute or provision . . . . AM General . . . succeeded in terminating its employment relationship with Mr. Wilson.").
amounts earned in excess of the FICA Wage Base are defined out of payroll tax “wages”). And although Congress has officially declared that payroll tax “wages” need not mean the same thing as “wages” for general income tax withholding purposes, differences appear most justifiable when an exclusion on one side creates the disparity; after all, one can rationally comprehend Congress deciding to limit the extent of its exclusionary grace. That mindset, however, fails to offer a potential framework to support inherent inclusionary differences. In CSX, the Court of Federal Claims threw up its hands. Perhaps the flag-waving was premature. The surrender certainly makes a degree of sense given that Congress itself simply resorts to definitional fiat by defining amounts earned in excess of the FICA Wage Base out of payroll tax “wages.” But given the highly regressive nature of the payroll tax (falling more heavily on low- and mid-wage workers) and its tax on work “stigma,” one could argue that in the interest of vertical taxpayer equity, relief from the tax is justifiable if, technically, the amount was not earned by sweat of the brow, even if the amount is left vulnerable to the workings of the progressive tax scheme. Per Flemming v. Nestor, Social Security benefit eligibility “rewards” those “who in their productive years were functioning members of the economy,” activity which presumably does not take the form of passive receipt of income. Further, one could argue that if the amount is neither compensation for services nor part of a standard remuneration package, then the amount does not constitute “wages” for payroll tax purposes or for general income tax withholding purposes. Thus, the tiers of taxability would be as follows in Table 2:

215. See 26 U.S.C. § 3121(a)(1) (2006) (excluding, for purposes of §§ 3101(a) and 3111(a), from the definition of “wages” amounts paid in excess of the appropriate contribution and benefit base).
218. Id. at 610 (emphasis added).
Table 2

<table>
<thead>
<tr>
<th>Form of Income</th>
<th>Taxability Standard</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll Tax “Wages”</td>
<td>An amount paid, in fact, for the rendering of services (“sweat of the brow”)</td>
<td>Salary</td>
</tr>
<tr>
<td>General Income Tax Withholding “Wages”</td>
<td>An amount paid, in fact, for the rendering of services or as part of what is widely regarded as a standard compensation package</td>
<td>Salary, sick pay, vacation pay</td>
</tr>
<tr>
<td>Neither Payroll Tax “Wages” Nor General Income Tax Withholding “Wages”</td>
<td>An amount paid neither for the rendering of services nor as part of what is widely regarded as a standard compensation package</td>
<td>Signing bonuses, severance, damages for work-related harms suffered</td>
</tr>
</tbody>
</table>

E. Payroll Tax Conception of “Wages” Versus Social Security Benefits Eligibility Conception

Given the links between work history, payroll taxes, and Social Security benefits, one might logically conclude that payroll tax “wages” should be the same as “wages” in the Social Security benefits eligibility context. An individual’s payment of payroll taxes on “wages” has to be understood, however, as the mere payment of a tax imposed under Congress’s power to tax income and not as an act establishing one’s inalienable right to collect Social Security benefits. Put differently, the payment of payroll taxes may establish eligibility for Social Security benefits, but given that Social Security benefits may be altered or even eliminated (within constitutional bounds), one does not have an established right to collect benefits merely because one has paid payroll taxes. Further, the Social Security system is “wildly redistributive.” Thus, the amount of payroll taxes an individual pays does

219. See U.S. Const. amend. XVI.
220. See Flemming, 363 U.S. at 611 (“We must conclude that a person covered by the [Social Security] Act has not such a right in benefit payments as would make every defeasance of ‘accrued’ interests violative of the Due Process Clause of the Fifth Amendment. This is not to say, however, that Congress may exercise its power to modify the statutory scheme free of all constitutional restraint.”).
221. See id.
not bear a direct relationship to the amount of Social Security benefits he ultimately receives, and no systemic compulsion for definitional parity exists in these two contexts. A broad conception per *Nierotko* in the benefits eligibility context may peacefully co-exist with a more narrow and precise definition per *Rowan Companies* in the payroll tax arena. Although it remains true that clear lines of definitional demarcation have emerged, the facial interrelation of the “wages” concept in the benefits eligibility context, the payroll tax context, and the income tax withholding context enhance the likelihood that the perception of definitional overlap will persist.

VI. CONCLUSION

Justice Scalia’s characterization of the settlement amount as “damages” in *Cleveland Indians* presents an intriguing question with respect to tenure relinquishment payments because tendering universities have vehemently contested the characterization of such payments as “wages.” That posture notwithstanding, the universities would likely have conceded that a payment prompted by a negotiated buyout certainly has the flavor of liquidated damages with respect to the early termination of a tenure contract. As damages of any flavor, longstanding tax precedent dictates that the tax treatment of the damages track the standard tax treatment of whatever the damages were paid in lieu of. But does that reality resolve the issue here? The United States would argue that a tenure relinquishment payment is either a payment/reward for past services or a lump sum payment in lieu of future salary (i.e., amounts which would constitute “wages” subject to payroll taxes if paid in fact). Conversely, the universities would argue that such a payment is merely a financial expediency, allowing the university to circumvent substantive and procedural hurdles (or the various costs of assured litigation or arbitration); such an amount, they would argue, does not take the place of salary or any other form of “wages” and thus escapes the burden of payroll taxes. The difficulty flows from tenure’s duality: it has an economic aspect (the right to future employment at a given salary through retirement), as well as a termination aspect (freedom from termination absent substantive justification and procedural due process). While it is certainly true that the economic aspect of tenure weighs heavily on the initial grant of tenure (when a faculty

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223. See *id*.
225. See Raytheon Prod. Corp. v. Comm’r, 144 F.2d 110 (1st Cir. 1944).
member is likely to be relatively young and the present value of future salary substantial), the equally heavy weight of the termination aspect is constant. After an individual has collected salary for several decades as a tenured member of the faculty, however, the economic aspect takes on reduced significance. In large part, it becomes an aspect of tenure that the individual has pursued and that the university has, over time, delivered. Further, given that tenure relinquishment payments often amount to less than a full year of salary,\textsuperscript{226} the lump sum cannot realistically be considered future years of salary reduced to present value. Thus, the buyout represents a payoff with respect to tenure’s termination aspect more so than anything else. Add to this the fact that the university has no interest in the mere relinquishment of tenure. For the various reasons mentioned earlier, the university seeks retirement in fact.

These factors and the service-rewarding emeritus\textsuperscript{227} machinery notwithstanding, the Service and at least a few courts are likely to continue indulging expansionist interpretations of \textit{Nierotko}. Such a likelihood is enhanced further by the burgeoning needs of the Social Security and Medicare programs, and the fact that general government expenditures feed off the payroll tax stream intensifies the pressure. Payroll tax revenue is a delectable diet, and the occasional indulgence of tax-producing proclivities is akin to surrendering to a sugary addiction. Unhealthy growth in conceptual girth is the inevitable result.

\textsuperscript{226} See Ehrenberg, \textit{supra} note 3.

\textsuperscript{227} Courts make no mention of or even acknowledge that which those in the academy consider reasonably obvious when it comes to recognizing admirable long-term service: universities routinely reward distinguished service to the university by awarding “emeritus” status both to tenured professors and administrators. Indeed, the word itself derives from \textit{emereri}, Latin for “earn one’s discharge by service.” \textit{New Oxford American Dictionary} 553 (2d ed. 2005).