SUPREME COURT OF THE UNITED STATES

No. 01–463

UNITED STATES, PETITIONER *v.* FIOR D'ITALIA, INC.

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

[June 17, 2002]

JUSTICE SOUTER, with whom JUSTICE SCALIA and JUSTICE THOMAS join, dissenting.

The Court holds that the Internal Revenue Service's statutory authorization to make assessments for unpaid taxes is reasonably read to cover a restaurateur's FICA taxes based on an aggregate estimate of all unreported employee tips. I believe that reading the statute so broadly saddles employers with a burden unintended by Congress, and I respectfully dissent.

I

Taxes on earned income imposed by the Federal Insurance Contributions Act (FICA) pay for employees' benefits under the Social Security Act, 49 Stat. 622, as amended, 42 U. S. C. §401 *et seq.* (1994 ed. and Supp. V). In the simplest case, the employee is taxed on what he receives, and the employer is taxed on what he pays. See 26 U. S. C. §§3101, 3111. For a long time, an employee's income from tips was not recognized as remuneration paid by the employer, and the corresponding FICA tax was imposed only on the employee. See Social Security Amendments of 1965, §313(c), 79 Stat. 382. In 1987, however, the Internal Revenue Code was amended to treat tip income within the remuneration on which the employer, too, is taxed, 26 U. S. C. §3121(q), and that is the present law.

The scheme is simple. The tips are includible in the employee's wages. The employee must report the amount of taxable tip income to the employer. §6053(a). "[L]arge food or beverage establishment[s]" must pass on that information to the Internal Revenue Service, §6053(c)(1), and must also report the total amount of tips shown on credit card slips. *Ibid.* The employer is subject to tax on the same amount of tip income listed on an employee's report to him and in turn reported by him to the Internal Revenue Service. For both the employer and the employee, however, taxable tip income is limited to income within what is known as the "wage band"; there is no tax on tips that amount to less than $20 in a given month, or on total remuneration in excess of the Social Security wage base ($53,400 and $55,500, respectively, in the years relevant to this case).

Because many employees report less tip income than they receive, their FICA taxes and their employers' matching amounts are less than they would be in a world of complete reporting. The IRS has chosen to counter dishonesty on the part of restaurant employees not by moving directly against them, but by going against their employers with assessments of unpaid FICA taxes based on an estimate of all tip income paid to all employees aggregated together. The Court finds these aggregated assessments authorized by the general provision for assessments of unpaid taxes, §6201, which benefits the Government with a presumption of correctness. See *United States* v. *Janis*, 428 U. S. 433, 440 (1976).[1] The practice of assessing FICA taxes against an employer on estimated aggregate tip income, however, raises anomaly after anomaly, to the point that one has to suspect that

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[1] In 1998, Congress altered the burdens of proof for tax cases, but the changes do not implicate FICA. See 26 U. S. C. §7491(a).

the Government's practice is wrong. An appreciation of these consequences, in fact, calls for a reading of the crucial provision, 26 U. S. C. §3121(q), in a straightforward way, which bars aggregate assessments and the anomalies that go with them.

II

A

The Social Security scheme of benefits and the FICA tax funding it have been characterized as a kind of "social insurance," *Flemming* v. *Nestor*, 363 U. S. 603, 609 (1960), in which employers and employees contribute matching amounts. Compare 26 U. S. C. §3101 with §3111. The payments that beneficiaries are entitled to receive are determined by the records of their wages earned. *Nestor, supra,* at 608.

Notwithstanding this basic structure, the IRS's aggregate estimation method creates a disjunction between amounts presumptively owed by an employer and those owed by an employee. It creates a comparable disproportion between the employer's tax and the employee's ultimate benefits, since an aggregate assessment does nothing to revise the earnings records of the individual employees for whose benefit the taxes are purportedly collected.[2] Thus, from the outset, the aggregate assessment fits poorly with the design of the system.

B

As the majority acknowledges, the next problem is that the aggregate estimation necessarily requires the use of

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[2]Although the scheme does not create a vested right to benefits in any employee, see *Flemming* v. *Nestor*, 363 U. S. 603, 608–611 (1960), the legislative choice to tie benefits to earnings history evinces a general intent to create a rough parity between taxes paid and benefits received.

generalized assumptions for calculating such estimates, and the assumptions actually used tend to inflate liability. In the first place, while the IRS's assumption that many employees are underreporting is indisputably sound, the assumption that every patron is not only tipping, but tipping 14.49% in 1991 and 14.29% in 1992, is probably not. Those percentages are based on two further assumptions: that patrons who pay with credit cards tip at the same rate as patrons who pay in cash, and that all patrons use the tip line of the credit card slip for tips, rather than to obtain cash. But what is most significant is that the IRS's method of aggregate estimation ignores the wage band entirely, assuming that all tips are subject to FICA tax, although this is not true in law, and certainly not always the case in fact.

C

The tendency of the Government's aggregation method to overestimate liability might not count much against it if it were fair to expect employers to keep the reports that would carry their burden to refute any contested assessment based on an aggregate estimate. But it is not fair.

Obviously, the only way an employer can refute probable inflation by estimate is to keep track of every employee's tips, *ante*, at 9, and at first blush, there might seem nothing unusual about expecting employers to do this.[3] The Code imposes a general obligation upon all

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[3] Of course, even the IRS has not explained the precise manner in which the employer is expected to generate such records. Before the Court of Appeals, the IRS argued that the employer could require employees to pool all tips, and thereby keep track of them. See 242 F. 3d 844, 848, n. 6 (CA9 2001). The court properly rejected this contention as "alter[ing] the way a restaurant does business. . . . It would be akin to saying that a restaurant must charge a fixed service charge in lieu of tips." *Ibid.* Before this Court, the IRS instead argued that "every employer should hire reliable people who they can trust to

taxpayers to keep records relevant to their liability according to regulations promulgated by the Secretary, 26 U. S. C. §6001, and, for the most part, the courts have viewed the burden on taxpayers to maintain such records as reasonable and, hence, as the justification for requiring taxpayers to disprove IRS estimates; the taxpayer who fails to attend to §6001 has only himself to blame. See, *e.g.*, *Kikalos* v. *Commissioner*, 190 F. 3d 791, 792, n. 1 (CA7 1999); *Cracchiola* v. *Commissioner*, 643 F.2d 1383, 1385 (CA9 1981); *Meneguzzo* v. *Commissioner*, 43 TC 824, 831 (1965).[4] But the first blush ignores the one feature of §6001 relevant here. The provision states a single, glaring exception: employers need not keep records "in connection with charged tips" other than "charge receipts, records necessary to comply with section 6053(c), and copies of statements furnished by employees under section 6053(a)." *Ibid.* Employers are expressly excused from any effort to determine whether employees are properly reporting their tips; the Code tells them that they need not keep the information specific to each employee that would be necessary to determine if any tips fell short of the estimates or outside the wage band.[5] Presumably because of this

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follow the rules." The official transcript records "Laughter." Tr. of Oral Arg. 27.

[4] Such is in keeping with the general rule that burdens shift to those with peculiar knowledge of the relevant facts. *Campbell* v. *United States*, 365 U. S. 85, 96 (1961) ("[T]he ordinary rule . . . does not place the burden upon a litigant of establishing facts peculiarly within the knowledge of his adversary"); *National Communications Assn.* v. *AT&T Corp.*, 238 F. 3d 124, 130 (CA2 2001) ("[A]ll else being equal, the burden is better placed on the party with easier access to relevant information"); 9 J. Wigmore, Evidence §2486, p. 290 (1981) ("[T]he burden of proving a fact is said to be put on the party who presumably has peculiar means of knowledge" (emphasis deleted)).

[5] The statute refers only to charged tips, rather than cash tips, but the IRS does not dispute that the employer has no obligation to keep any records beyond those specifically required under 26 U. S. C. §6053,

statutory exception, the Secretary's regulations regarding employer recordkeeping do not impose any obligations beyond those mentioned in §6001. See 26 CFR §31.6001–5 (2001) (describing required records). This absolution from recordkeeping is mirrored by the fact that tips are uniquely excepted from the general rule that remuneration must be reported in W–2 statements. See 26 U. S. C. §6041(e). The upshot is that Congress has enacted a singular exception to the duty to keep records that would allow any ready wage band determinations or other checks on estimates, while the aggregate assessment practice of the IRS virtually reads the exception out of the Code.

The majority doubts that there is any practical difference between determining the liability of one employee, very possibly with an estimation similar to the one used here, and estimating the aggregate amount for an employer. *Ante*, at 9–10. But determinations limited to an individual employee will necessarily be more tailored, if only by taking the wage band into account. In fact, any such determination would occur in consequence of some audit of the employee, who would have an incentive to divulge information to contest the IRS's figures where possible, and generate the very paper trail an employer would need to contest liability while availing himself of the exception in §6001.

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and the IRS's regulations on the subject do not impose any requirements with respect to cash tips. See 26 CFR §31.6001–5 (2001). Moreover, it would be irrational to read 26 U. S. C. §6001 to require an employer to keep detailed records only of cash tips, while, for example, being relieved of the burden to record which employees received which charged tips, or whether the tip space was used for something other than tips, or how employees allocated charged tips amongst themselves via the process of "tipping out" (sharing tips with supporting waitstaff who do not receive their own tips, such as bartenders and hosts).

D

The strangeness of combining a statute excusing employers from recordkeeping with an administrative practice of making probably inflated assessments stands out even more starkly in light of the eccentric route the Government has to follow in a case like this in order to benefit from the presumption of correctness that an aggregate assessment carries. Under the general authorization to make assessments, 26 U. S. C. §6201, on which the Government relies, any assessment is preceded by liability for taxes. §6201(a) ("The Secretary is authorized . . . to make the inquiries, determinations, and assessments of all taxes . . . which have not been duly paid . . ."); *ante*, at 3 ("An 'assessment' amounts to an IRS determination that a taxpayer owes the Federal Government a certain amount of unpaid taxes"). After, but only after, assessment can the IRS take the further step of issuing notice and demand for the unpaid taxes assessed, §6303, so as to authorize the IRS to levy upon the taxpayer's property, or impose liens, §§6321, 6331.

In the case of an employer's liability for FICA taxes on tips, however, this sequence cannot be followed if the employee does not report the tips to the employer in the first place, for it is the report, not the employee's receipt of the tips, that raises the employer's liability to pay the FICA tax. The employer may know from the credit slips that the employees' reports are egregiously inaccurate (wage band or no wage band), but the employer is still liable only on what the employee declares. In fact, the effect of §6053(c) is such that employers cannot help but know when underreporting is severe, since they are required to give the IRS a summary of the amount of reported tips and the amount of charged tips. Nonetheless, the employer remains liable solely for taxes on the re-

ported tips.[6]

Indeed, even if the employer, seeing a disparity, paid extra FICA taxes on the assumption that the employees had underreported tips, the extra payment would be treated as an overpayment. See Tr. of Oral Arg. 8; *Jones* v. *Liberty Glass Co.*, 332 U. S. 524, 531 (1947) (overpayment is "any payment in excess of that which is properly due"). The overall implication is that employers are meant to pay taxes based on specific information provided by others. As a practical matter, the tips themselves are not the true basis for liability; instead, it is an employee report that creates the obligation.

Some event must therefore trigger liability for taxes on unreported tips before the IRS can make the assessment, and this event turns out to be the notice and demand for which §3121(q) makes special provision in such a case.[7] Only after notice and demand can the Government proceed to assessment under §6201. Whereas the usual sequence is assessment, then notice and demand, see 26 U. S. C. §6303, here it is notice and demand, then assessment.

The IRS does not dispute this. It concedes that it does not rely upon §6201 before issuing the notice, see Reply Brief for United States 15–16, but instead performs a "pre-assessment" estimate (for which, incidentally, no statutory

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[6] In fact, the obligation to report charged tips was imposed before employers had any FICA tax obligation beyond tips that substituted for minimum wage, and the reporting obligations of §6053(c) were devised to assist the IRS in its collections efforts against employees, despite the IRS's use of it here as a basis for auditing Fior D'Italia.

[7] The majority takes note of this unusual scheme, but finds significance only in the fact that until notice issues (and liability arises), interest does not run. *Ante*, at 10–11. But to interpret the statute as nothing more than a method of preventing the running of interest avoids the significance of 3121(q), because there is already a statute that prevents interest running on unpaid FICA taxes. §6205(a)(1).

authorization exists). Then it issues notice and (liability having now attached) uses the same estimate for the official assessment under §6201.

Again, at first blush, it is tempting to say that the sequence of events may be unusual, but under the aggregate assessment practice the employer-taxpayer ends up in the same position he would have been in if he failed to pay FICA taxes on reported tips. But there are two very significant differences. It is true that the employer who is delinquent as to reported tips ends up subject to liability on the basis of third-party action (the employee's report) which assessment invests with a presumption of correctness, and which notice and demand then make a basis for possible liens and levies. But in that case the employer's liability, and exposure to collection mechanisms, is subject to the important safeguard of the employee's report. Whatever the employee may do, it will not be in his interest to report more tips than he received, exposing himself (and, incidentally, his employer) to extra taxation. But this safeguard is entirely lost to the employer, through no fault of his own, if the Government can make aggregate assessments. The innocent employer has few records and no protection derived from the employee's interest. Yet without any such protection he is, on the Government's theory, immediately liable for the consequences of notice and demand at the very instant liability arises.

The second difference goes to the authority for estimating liability. The IRS finds this authority implicit in §6201, which authorizes assessments. *Ante*, at 4. In the usual case, the estimate is thus made in calculating the assessment, which occurs after the event that creates the liability being estimated and assessed. But in the case of the tips unreported by the employee, there would be no liability until notice and demand is made under §3121(q), and it is consequently at this point that the estimate is required. The upshot is that the estimate has to occur

before the statute claimed to authorize it, §6201, is even applicable. That is, the IRS says it can estimate because it can assess, and it can assess because it can previously estimate. Reasoning this circular may warrant suspicion.

E

There is one more source of suspicion. In 1993, Congress enacted an income tax credit for certain employers in the amount of FICA taxes paid on tips in excess of the minimum wage. 26 U. S. C. §45B. The existence of the credit creates a peculiar scheme, for unless we are to assume that restaurateurs are constantly operating on the knife-edge of solvency, never able to use the credit (even with its 20-year carryforward, see 26 U. S. C. §39), the IRS has little reason to expect to gain much from the employer-taxpayer; the collection effort will probably result in no net benefit to the Government (except, perhaps, as an interest-free loan).[8] And because, as noted, the aggregate method chosen by the IRS will not affect individual employees' wage-earning records, the estimates do not even play much of a bookkeeping role. There is something suspect, then, in the IRS's insistence on conducting audits of employers, without corresponding audits of employees, for the purpose of collecting FICA taxes that will ultimately be refunded, that do not increase the accuracy of individual earnings records, and probably overestimate the true amount of taxable earnings.

In fact, the only real advantage to the IRS seems to be that the threat of audit, litigation, and immediate liability may well force employers to assume the job of monitoring their employees' tips to ensure accurate reporting. But if

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[8]At oral argument, the Government contended that the payment of the FICA tax, coupled with the §45B credit, benefited its accounting by permitting payments to be appropriately allocated between the Social Security trust fund and general revenue. See Tr. of Oral Arg. 20–21.

that explanation for the Government's practice makes sense of it, it also flips the Government from the frying pan into the fire. Congress has previously stymied every attempt the IRS has made to impose such a burden on employers. In the days when employers were responsible only for withholding the employee's share of the FICA tax, the IRS attempted to force employers to include tip income on W–2 forms; this effort was blocked when Congress modified 26 U. S. C. §6041 to exclude tip income expressly from the W–2 requirements. See Revenue Act of 1978, §501(b), 92 Stat. 2878. When the IRS interpreted the credit available under §45B to apply only to tips reported by the employee pursuant to 26 U. S. C. §6053(a), Congress overruled the IRS and clarified that the credit would apply to all FICA taxes paid on tips above those used to satisfy the employer's minimum wage obligations. See Small Business Job Protection Act of 1996, Pub. L. No. 104–188, §1112(a), 110 Stat. 1759. Finally, when the IRS developed its Tip Reporting Alternative Commitment (TRAC) program, *ante,* at 11–12, Congress forbade the IRS from "threaten[ing] to audit any taxpayer in an attempt to coerce the taxpayer" into participating. Internal Revenue Service Restructuring and Reform Act of 1998, §3414, 112 Stat. 755.[9] And although the use of a threatened aggre-

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[9]To some extent, the modification of the §45B credit and TRAC may be taken as congressional awareness of the IRS's practice of making aggregate assessments. After all, there is no need to clarify that §45B is available for taxes on unreported tips unless such taxes are, in fact, being paid, and the TRAC program itself depends on the existence of aggregate assessments, because the "carrot" offered to employers to encourage participation is the IRS's promise to refrain from such assessments.

With respect to §45B, however, prior to Congress's modifications, the IRS regulations did not allow for the credit even when an individual employee was assessed and corresponding notice and demand issued to the employer. See 58 Fed. Reg. 68033 (1993) (temporary regulation

gate estimate (after an audit) to induce monitoring of employee tips may not technically run afoul of that statute, it is difficult to imagine that Congress would allow the aggregation practice as a lever on employers, when it forbade the use of an audit for the same purpose.

III

Consider an alternative. I have noted already that even the Government tacitly acknowledges the crucial role of §3121(q), the source of its authority to issue notice and demand, without which there is no liability on the employer's part for FICA taxes on unreported tips and thus no possibility of assessment under §6201. It makes sense, then, to understand the scope of authority to make the assessment as being limited by the scope of the authority to issue notice and demand, and it likewise makes sense to pay close attention to the text of that authorization.

The special provision in §3121(q) for notice and demand against an employer says nothing and suggests nothing about aggregate assessments. It reads that when an employer was furnished "no statement including such tips" or was given an "inaccurate or incomplete" one, the remuneration in the form of "such tips" shall be treated as if paid on the date notice and demand is made to the employer. 26 U. S. C. §3121(q). "[S]uch tips" are described as "tips received by an employee in the course of his employment." *Ibid.* Thus, by its terms, the statute

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§1.45B–1T). Thus, Congress's clarification did not depend on the existence of aggregate assessments. As for TRAC, at the time that Congress forbade the IRS from coercing participation, the IRS had actually halted the aggregate assessment practice. See Director, Office of Employment Tax Administration and Compliance, Memorandum for Regional Chief Compliance Officers (June 16, 1998), App. 106–107. Moreover, the simple (and realistic) answer is just that Congress did as asked; restaurateurs complained about a specific practice, *i.e.,* threatened audits, and Congress responded with a targeted statute.

provides for notice and demand for the tax on the tips of "an employee," not on the tips of "employees" or "all employees" aggregated together. And, of course, if notice and demand is limited to taxes on tips of "an employee," that is the end of aggregate estimates.

It is true that under the Dictionary Act, 1 U. S. C. §1, a statutory provision in the singular may include the plural where that would work in the context. *Ibid.* "[A]n employee" could cover "employees" and the notice and demand could cover tips received during "their employment," "unless the context indicates otherwise," *ibid.* But here the context does indicate otherwise. The anomalies I have pointed out occur when the singular "employee" in §3121(q) is read to include the plural, which in turn is crucial to allowing aggregate notice, demand, and assessment; and it turns out that reading the statute to refer only to a particular employee's tips and limiting notice, demand, and assessment accordingly, goes far to abridge the catalog of oddities that come with the Government's position.

First, sticking to the singular means that the employer will not be assessed more tax than the employee himself should pay; whether or not the employee is sued for a like amount, the respective liabilities of employer and employee will be restored to parity. And by keying the employer's liability to a particular employee, the near-certainty of overassessment will be replaced with a likelihood of an accurate assessment taking into consideration the wage band of taxability under FICA.

Second, the fact that the employer has exercised his express, statutory option to decline to keep tipping records on his work force will no longer place him at such an immediate disadvantage. It will be relatively easy to discover the basis for the tax calculation in a particular instance.

Third, if indeed the Government first establishes the

employee's liability for unreported tips, notice and demand under §3121(q) will then serve what on its face seems to be its obvious purpose, to provide the employer with reliable information, like the employee tip reports that similarly trigger liability, so that the employer will have no further need for keeping track of employee tips. Although this is not the time to decide whether the IRS must formally audit the employee's own tax liability first, there is at least one reason to think Congress assumed that it would. There is no statute of limitations on an employer's FICA tax liability for unreported tips (because the statute does not run until after liability attaches, and no time limits are imposed upon the issuance of the notice that triggers liability). But there is a statute of limitations for assessments against employees. 26 U. S. C. §6501. Conditioning the employer's liability on a parallel obligation of the employee would in effect place a limitation period on the employer's exposure.

Finally, of course, the tension with Congress's admonition that the IRS not "threaten to audit any taxpayer in an attempt to coerce the taxpayer" into participating in TRAC will be eliminated. If the employer is liable only after an individual employee's delinquency has been calculated, the use of mass assessments to force an employer, in self-defense, to institute TRAC will simply vanish.

Thus, the context establishes that a singular reading is the one that makes sense by eliminating the eccentricities entailed by the aggregate reading, some of which seem unfair to employer taxpayers. Of course, this means that the problem of underreporting tips will be harder to solve, but it seems clear that Congress did not mean to solve it by allowing the IRS to use its assessment power to shift the problem to employers. I would therefore affirm the judgment of the Ninth Circuit.