

Opinion of the Court

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D. C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

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 BREYER delivered the opinion of the Court.

Employers must pay Federal Insurance Contribution Act taxes (popularly known as Social Security taxes or FICA taxes), calculated as a percentage of the wages—including the tips—that their employees receive. 26 U. S. C. §§3101, 3111, 3121(q). This case focuses upon the Government’s efforts to assess a restaurant for FICA taxes based upon tips that its employees may have received but did not report. We must decide whether the law authorizes the Internal Revenue Service (IRS) to base that assessment upon its *aggregate estimate* of all the tips that the restaurant’s customers paid its employees, or whether the law requires the IRS instead to determine total tip income by estimating each *individual employee’s* tip income separately, then adding individual estimates together to create a total. In our view, the law authorizes the IRS to use the aggregate estimation method.

I

The tax law imposes, not only on employees, but also “on every employer,” an “excise tax,” *i.e.*, a FICA tax, in an amount equal to a percentage “of the wages . . . paid by him with respect to employment.” §3111(a) (setting forth

Opinion of the Court

basic Social Security tax); §3111(b) (using identical language to set forth additional hospital insurance tax). It specifies that “tips received by an employee in the course of his employment shall be considered remuneration” and “deemed to have been paid by the employer” for purposes of the FICA tax sections. §3121(q). It also requires an employee who receives wages in the form of tips to report the amount of those tips to the employer, who must send copies of those reports to the IRS. 26 CFR §31.6011(a)–1(a) (2001).

In 1991 and 1992 the reports provided to San Francisco’s Fior D’Italia restaurant (and ultimately to the IRS) by the restaurant’s employees showed that total tip income amounted to \$247,181 and \$220,845, in each year respectively. And Fior D’Italia calculated and paid its FICA tax based on these amounts. The same reports, however, also showed that customers had listed tips on their credit card slips amounting to far more than the amount reported by the employees (\$364,786 in 1991 and \$338,161 in 1992). Not surprisingly, this discrepancy led the IRS to conduct a compliance check. And that check led the IRS to issue an assessment against Fior D’Italia for additional FICA tax.

To calculate the added tax it found owing, the IRS used what it calls an “aggregate estimation” method. That method was a very simple one. The IRS examined the restaurant’s credit card slips for the years in question, finding that customers had tipped, on average, 14.49% of their bills in 1991 and 14.29% in 1992. Assuming that cash-paying customers on average tipped at those rates also, the IRS calculated total tips by multiplying the tip rates by the restaurant’s total receipts. It then subtracted tips already reported and applied the FICA tax rate to the remainder. The results for 1991 showed total tips amounting to \$403,726 and unreported tips amounting to \$156,545. The same figures for 1992 showed \$368,374 and

Opinion of the Court

\$147,529. The IRS issued an assessment against Fior D'Italia for additional FICA taxes owed, amounting to \$11,976 for 1991 and \$11,286 for 1992.

After paying a portion of the taxes assessed, the restaurant brought this refund suit, while the IRS filed a counterclaim for the remainder. The restaurant argued that the tax statutes did not authorize the IRS to use its “aggregate estimation” method; rather, they required the IRS first to determine the tips that each individual employee received and then to use that information to calculate the employer’s total FICA tax liability. Simplifying the case, the restaurant agreed that “[f]or purpose[s] of this litigation,” it would “not dispute the facts, estimates and/or determinations” that the IRS had “used . . . as a basis for its calculation” of the employees’ “aggregate unreported tip income.” App. 35. And the District Court decided the sole remaining legal question—the question of the *statutory authority* to estimate tip income in the aggregate—in Fior D'Italia’s favor.

The Court of Appeals affirmed the District Court by a vote of 2 to 1, the majority concluding that the IRS is not legally authorized to use its aggregate estimation method, at least not without first adopting its own authorizing regulation. In light of differences among the Circuits, compare 242 F. 3d 844 (CA9 2001) (case below), with 330 *West Hubbard Restaurant Corp. v. United States*, 203 F. 3d 990, 997 (CA7 2000), *Bubble Room, Inc. v. United States*, 159 F. 3d 553, 568 (CA Fed. 1998), and *Morrison Restaurants, Inc. v. United States*, 118 F. 3d 1526, 1530 (CA11 1997), we granted the Government’s petition for certiorari. We now reverse.

II

An “assessment” amounts to an IRS determination that a taxpayer owes the Federal Government a certain amount of unpaid taxes. It is well established in the tax

Opinion of the Court

law that an assessment is entitled to a legal presumption of correctness—a presumption that can help the Government prove its case against a taxpayer in court. See, *e.g.*, *United States v. Janis*, 428 U. S. 433, 440 (1976); *Palmer v. IRS*, 116 F. 3d 1309, 1312 (CA9 1997); *Psaty v. United States*, 442 F. 2d 1154, 1160 (CA3 1971); *United States v. Lease*, 346 F. 2d 696, 700 (CA2 1965). We consider here the Government's authority to make an assessment in a particular way, namely by directly estimating the aggregate tips that a restaurant's employees have received rather than estimating (and then summing) the tips received by each individual employee.

The Internal Revenue Code says that the IRS, as delegate of the Secretary of Treasury,

“is authorized and required to make the inquiries, determinations, and *assessments* of all taxes . . . which have not been duly paid” 26 U. S. C. §6201(a) (emphasis added).

This provision, by granting the IRS assessment authority, must simultaneously grant the IRS power to decide *how* to make that assessment—at least within certain limits. And the courts have consistently held that those limits are not exceeded when the IRS *estimates* an individual's tax liability—as long as the method used to make the estimate is a “reasonable” one. See, *e.g.*, *Erickson v. Commissioner*, 937 F. 2d 1548, 1551 (CA10 1991) (estimate made with reference to taxpayer's purchasing record was “presumptively correct” when based on “reasonable foundation”). See also *Janis*, *supra*, at 437 (upholding estimate of tax liability over 77-day period made by extrapolating information based on gross proceeds from 5-day period); *Dodge v. Commissioner*, 981 F. 2d 350, 353–354 (CA8 1992) (upholding estimate using bank deposits by taxpayer); *Pollard v. Commissioner*, 786 F. 2d 1063, 1066 (CA11 1986) (upholding estimate using statistical tables reflecting cost of living

Opinion of the Court

where taxpayer lived); *Gerardo v. Commissioner*, 552 F. 2d 549, 551–552 (CA3 1977) (upholding estimate using extrapolation of income over 1-year period based on gross receipts from two days); *Mendelson v. Commissioner*, 305 F. 2d 519, 521–522 (CA7 1962) (upholding estimate of waitress’ tip income based on restaurant’s gross receipts and average tips earned by all waitresses employed by restaurant); *McQuatters v. Commissioner*, 32 CCH TCM 1122 (1973) (same).

Fior D’Italia does not challenge this basic principle of law. Rather, it seeks to explain why this principle should not apply here, or why it should not determine the outcome of this case in the Government’s favor.

A

Fior D’Italia’s primary argument rests upon the statute that imposes the FICA tax. It points out that the tax law says there is “imposed on every employer” an “excise tax” calculated on the basis of “wages . . . paid by him” as those “wages” are “defined in” §3121. §§3111(a), (b). It adds that the subsection of §3121 which specifies that “wages” includes tips (subsection q) refers to “tips” as those “received by *an* employee in the course of *his* employment,” *i.e.*, to tips received by each employee individually. (Emphasis added.) Fior D’Italia emphasizes §3121(q)’s reference to the employee in the singular to conclude that the “employer’s liability for FICA taxes therefore attaches to *each* of these individual payments, not when they are later summed and reported.” Brief for Respondent 28 (emphasis in original).

In our view Fior D’Italia’s linguistic argument makes too much out of too little. The language it finds key, the words “tips received by an employee” is contained in a definitional section, §3121(q), not in the sections that impose the tax, §§3111(a), (b). The definitional section speaks in the singular. It says that an employee’s (singu-

Opinion of the Court

lar) tips “shall be considered remuneration” for purposes of the latter, tax imposing sections. §3121(q). But the latter operational sections speak in the plural. They impose on employers a FICA tax calculated as a percentage of the “wages” (plural) paid to “individuals” (plural) by the employer “with respect to employment.” §§3111(a), (b). The operational sections consequently impose liability for the *totality* of the “wages” that the employer pays, which totality of “wages,” says the definitional section, shall include the tips that each individual employee earns. It is as if a tax were imposed on “all of a restaurant’s dishes,” with a definitional section specifying that “dishes” shall “include each customer’s silverware.” We simply do not see how this kind of language, taken as a whole, argues against use of an aggregate estimation method that seeks to determine the restaurant’s total FICA tax liability.

B

The Ninth Circuit relied in part upon two other statutory provisions. The first, 26 U. S. C. §446(b), has been interpreted to authorize the IRS to use methods of estimation for determining *income* tax liability. See, *e.g.*, *Mendelson, supra*, at 521–522 (authorizing estimate of waitress’ gross receipts). The court felt this provision negatively implies a lack of IRS authority to use the aggregate estimation method in respect to other taxes, such as employer FICA taxes, where no such provision applies. 242 F. 3d, at 849. The second, 26 U. S. C. §6205(a)(1), authorizes the Secretary to adopt regulations that prescribe mechanisms for employers to adjust FICA tax liability. The court felt this provision negatively implies a lack of IRS authority to use an aggregate estimation method in the absence of a regulation. 242 F. 3d, at 851.

After examining the statutes, however, we cannot find any negative implication. The first says that, where a

Opinion of the Court

taxpayer has used “a method of accounting” that “does not clearly reflect income,” or has used “no method of accounting” at all, “the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income.” §446(b). This provision applies to only one corner of income tax law, and even within that corner it says nothing about any particular method of calculation. To read it negatively would significantly limit IRS authority in that respect both within and outside the field of income tax law. And there is simply no reason to believe that Congress intended any such limitation.

Section 6205(a)(1) refers to certain employment taxes, including FICA taxes, and says that when an employer initially pays “less than the correct amount of tax,” then “proper adjustments . . . shall be made, without interest,” in accordance with “regulations.” The IRS has made clear that this provision refers to an employer’s “adjustments,” say, in an initially underreported tax liability, made *before* the IRS has assessed an underpayment. See generally 26 CFR §31.6205–1 (2001). Again, there is simply no reason to believe that Congress, in writing this provision applicable to a small corner of tax law, intended, through negative implication, to limit the IRS’ general power to assess tax deficiencies. Indeed, Fior D’Italia has not advanced in this Court either “negative implication” argument relied on by the Ninth Circuit.

C

Fior D’Italia next points to several features of an “aggregate” estimate that, in its view, make it “unreasonable” (and therefore contrary to law) for the IRS to use that method. First, it notes that an aggregate estimate will sometimes include tips that should not count in calculating the FICA tax the employer owes. The law excludes an employee’s tips from the FICA wages base insofar as those

Opinion of the Court

tips amount to less than \$20 in a month. 26 U. S. C. §3121(a)(12)(B). It also excludes the portion of tips and other wages (including fixed salary) an employee receives that rises above a certain annual level—\$53,400 in 1991 and \$55,500 in 1992. §3121(a)(1); 242 F. 3d, at 846, n. 4. These ceilings mean that if a waiter earns, say, \$36,000 in fixed salary, reports \$20,000 in tips, and fails to report \$10,000 in tips, the restaurant would *not* owe additional taxes, because the waiter's reported income (\$56,000) already exceeds the FICA ceiling. But if that waiter earns \$36,000 in fixed salary, reports \$10,000 in tips, and fails to report another \$10,000 in tips, the restaurant *would* owe additional taxes on the unreported amount, because the waiter's reported income of \$46,000 falls below the FICA ceiling.

Second, Fior D'Italia points out that an aggregate calculation based on credit card slips can overstate the aggregate amount of tips because it fails to account for the possibilities that: (1) customers who pay cash tend to leave a lower percentage of the bill as a tip; (2) some customers "stiff" the waiter, leaving no tip at all; (3) some customers write a high tip on the credit card slip, but ask for some cash back, leaving a net lower amount; and (4) some restaurants deduct the credit card company fee from the tip, leaving the employees with a lower net amount.

Fior D'Italia adds that these potential errors can make an enormous difference to a restaurant, for restaurant profits are often low, while the tax is high. Brief for Respondent 9–10, n. 6 (asserting that an assessment for unreported tips for all years since employer FICA tax provision was enacted would amount to two years' total profits). Indeed, the restaurant must pay this tax on the basis of amounts that the restaurant itself cannot control, for the restaurant's customers, not the restaurant itself, determine the level of tips. Fior D'Italia concludes that the IRS should avoid these problems by resting its as-

Opinion of the Court

assessment upon individual calculations of employee tip earnings, and argues that the IRS' failure to do so will always result in an overstatement of tax liability, rendering any assessment that results from aggregate estimates unreasonable and outside the limits of any delegated IRS authority.

In our view, these considerations do not show that the IRS' aggregate estimating method falls outside the bounds of what is reasonable. It bears repeating that in this litigation, Fior D'Italia stipulated that it would not challenge the particular IRS calculation as inaccurate. Absent such a stipulation, a taxpayer would remain free to present evidence that an assessment is inaccurate in a particular case. And we do not accept Fior D'Italia's claim that restaurants are unable to do so—that they “simply do not have the information to dispute” the IRS assessment. Tr. of Oral Arg. 36. Why does a restaurant owner not know, or why is that owner unable to find out: how many busboys or other personnel work for only a day or two—thereby likely earning less than \$20 in tips; how many employees were likely to have earned more than \$55,000 or so in 1992; how much less cash-paying customers tip; how often they “stiff” waiters or ask for a cash refund; and whether the restaurant owner deducts a credit card charge of, say 3%, from employee tips? After all, the restaurant need not prove these matters with precision. It need only demonstrate that use of the aggregate method in the particular case has likely produced an inaccurate result. And in doing so, it may well be able to convince a judge to insist upon a more accurate formula. See, *e.g.*, *Erickson*, 937 F. 2d, at 1551 (“*Some* reasonable foundation for the assessment is necessary to preserve the presumption of correctness” (emphasis in original)).

Nor has Fior D'Italia convinced us that individualized employee assessments will inevitably lead to a more “reasonable” assessment of employer liability than an aggre-

Opinion of the Court

gate estimate. After all, individual audits will be plagued by some of the same inaccuracies Fior D'Italia attributes to the aggregate estimation method, because they are, of course, *based on estimates themselves*. See, e.g., *Mendelson*, 305 F. 2d, at 521–522; *McQuatters v. Commissioner*, CCH TCM 1122 (1973). Consequently, we cannot find that the aggregate method is, as a general matter, so unreasonable as to violate the law.

D

Fior D'Italia also mentions an IRS regulation that it believes creates a special problem of fairness when taken together with the “aggregate” assessment method. That regulation says that an employer, when calculating its FICA tax, must “include wages received by an employee in the form of tips *only to the extent of the tips reported . . . to the employer*.” 26 CFR §31.6011(a)–1(a) (2001) (emphasis added). How, then, asks Fior D'Italia, could the employer have calculated tax on a different amount, namely: (1) the amount of tips “reported”; plus (2) the amount of tips *received but not reported*? Indeed, Fior D'Italia itself did not do so initially, presumably because this regulation said it should not do so. See Brief for Respondent 16–17. And, if it should not do so, is it not seriously unfair for the IRS later to assess against it a tax deficiency based on this latter figure? “[T]here is no practical or legally authorized way,” Fior D'Italia complains, for the restaurant to include the additional amount of tips for which the IRS might later seek tax payment. *Id.*, at 16.

The statute itself, however, responds to this concern. It says that, insofar as tips were received but not reported to the employer, *that* remuneration (*i.e.*, the unreported tips) shall not be deemed to have been paid by the employer until “the date on which notice and demand for such taxes is made to the employer by the Secretary.” 26 U. S. C. §3121(q). This provision makes clear that it is not unfair

Opinion of the Court

or illegal to assess a tax deficiency on the unreported tips, for penalties will not attach and interest will not accrue unless the IRS actually demands the money *and* the restaurant refuses subsequently to pay the amount demanded in a timely fashion. See generally, Rev. Rul. 95–7, 1995–4 I. R. B. 44. Indeed, the statute (and its accompanying Revenue Ruling) contemplates both a restaurant that does not police employee tip reporting and a later assessment based on unreported tips. It makes clear that, at most, such a restaurant would have to create a reserve for potential later tax liability. Although the reporting scheme may place restaurants in an awkward position, the Tax Code seems to contemplate that position; and its bookkeeping awkwardness consequently fails to support the argument that aggregate estimation is unlawful.

E

Finally, Fior D'Italia suggests that the IRS is putting its “aggregate estimate” method to improper use. It traces a lengthy history of disagreement among restaurant workers, restaurant owners, and the IRS as to how best to enforce the restaurants’ legal obligation to pay FICA taxes on unreported tip income. It notes that the IRS has agreed to create a special program, called the “Tip Reporting Alternative Commitment,” whereby a restaurant promises to establish accurate tip reporting procedures in return for an IRS promise to base FICA tax liability on reported tips alone. It adds that any coercion used to force a restaurant to enter such a program (often unpopular with employees) would conflict with the views of Members of Congress and IRS officials, who have said that a restaurant should not be held responsible for its employees’ failure to report all their tips as income. See, *e.g.*, Letter of Members of Congress to Secretary of Treasury Lloyd Bentsen, 32 Tax Analysts’ Daily Tax Highlights & Documents 3913 (Mar. 4, 1994); App. 106, 107. It adds that

Opinion of the Court

Congress has enacted this view into two special laws: the first of which gives restaurants a nonrefundable tax credit on FICA taxes paid, *i.e.*, permits restaurants to offset any FICA it pays on employee tips on a dollar for dollar basis against its own income tax liability, 26 U. S. C. §45B; and the second of which forbids the IRS from “threaten[ing] to audit” a restaurant in order to “coerce” it into entering the special tip-reporting program. Internal Revenue Service Restructuring and Reform Act of 1998, 112 Stat. 755.

Fior D'Italia says that the IRS' recent use of an “aggregate estimate” approach runs contrary to the understanding that underlies this second statute, for it “effectively forces the employer into . . . verifying, investigating, monitoring, and policing compliance by its employees—responsibilities which Congress and the Courts have considered, evaluated, and steadfastly refused to transfer from IRS to the employer.” Brief for Respondent 9. And it suggests that the IRS intends to use a legal victory here as a “threat,” say to reopen back tax years, in order to require restaurant owners “to force” their “employees to report” all tips. *Id.*, at 14. Why else, asks Fior D'Italia, would the IRS bring this case? After all, given the dollar for dollar FICA/income tax setoff, this case may not even produce revenue for the Government.

Fior D'Italia's “abuse of power” argument, however, does not constitute a ground for holding unlawful the IRS' use of aggregate estimates. Even if we assume, for argument's sake, that an improper motive could render unlawful the use of a statutorily permissible enforcement method in certain circumstances, cf. *United States v. Powell*, 379 U. S. 48, 58 (1964), we note that Fior D'Italia has not demonstrated that the IRS has acted illegally *in this case*. Instead it has presented a general claim to the effect that the aggregate estimation method lends itself to abusive agency action. But we cannot find agency action unreasonable in all cases simply because of a general *possibility* of abuse—a

Opinion of the Court

possibility that exists in respect to many discretionary enforcement powers. Cf. *Heckler v. Chaney*, 470 U. S. 821, 831 (1985).

The statutes and congressional documents that protect restaurants from onerous monitoring requirements consequently do not support Fior D'Italia's argument that aggregate estimates are statutorily prohibited. For example, the Internal Revenue Service Restructuring and Reform Act prohibits the IRS from "threaten[ing] to audit" restaurants as a means to "coerce" them into policing employee tip reporting, *supra*, at 12, but Fior D'Italia does not claim that the IRS has violated this statute. Nor, for that matter, has Fior D'Italia presented evidence that this particular litigation would fail to yield revenue to the Government (due to the availability of the FICA tax credit), or convincingly explained, even if so, why that fact, while making the case unremunerative, would automatically make it improper. And while other documents show that Congress has expressed concern regarding a restaurant's difficulty in trying to supervise its employees' reporting of their tips, they do not suggest that the aggregate estimate method is an unreasonable way of ascertaining unpaid FICA taxes for which the employer is indisputably liable (particularly when one recalls that the taxpayer generally remains free to challenge the accuracy of the calculation at issue, even though this taxpayer has waived its right to do so). Rather, as we have shown, the relevant Code provisions and case law support the use of aggregate estimates. See *supra*, at 3–5, 9–11.

We conclude that Fior D'Italia's discussion of IRS "abuse" is insufficient to show that the agency's use of aggregate estimates is prohibited by law. In saying this, we recognize that Fior D'Italia remains free to make its policy-related arguments to Congress.

III

For these reasons, and because Fior D'Italia has stipu-

Opinion of the Court

lated that it does not challenge the accuracy of the IRS assessment in this case, the decision of the Court of Appeals is

Reversed.