ACTION ON DECISION

Subject: *Union Pacific Railroad Company v. United States*, 865 F.3d 1045 (8th Cir. 2017), *rev'g* No. 8:14CV237 (D. Neb. July 1, 2016).

Issue: Whether lump-sum payments made to unionized employees upon ratification of collective bargaining agreements are taxable compensation under the Railroad Retirement Tax Act ("RRTA").

Discussion:

In the case at issue, Union Pacific Railroad Company ("taxpayer") sought to recover both the employer and employee portions of the RRTA taxes that it paid on lump-sum payments ("ratification payments") that it made to unionized employees upon ratification of collective bargaining agreements.[1]

The Eighth Circuit held that the ratification payments were not taxable compensation under the RRTA because the payments were not made "in the service of the employer" under § 3231(d) because the employer "[did] not exercise control over whether a union ratifies a collective bargaining agreement." 865 F.3d at 1053.

The Eighth Circuit premised this holding on its conclusion that RRTA taxes apply to a narrower scope of services than that to which Federal Insurance Contributions Act (FICA) taxes apply, stating:

> We disagree with the district court's approach because instead of taxing payment for "services," the FICA taxes payment for "employment," which is defined broadly as "any service, of whatever nature, performed . . . by an employee for the person employing him." 26 U.S.C. § 3121(b). Transplanting the FICA's definition into the RRTA disregards the RRTA's focus on the authority and control that an employer exercises over an employee in determining whether the employee is performing a "service."

Id. The Internal Revenue Service ("IRS") disagrees with this interpretation of the statutory language and scope of the RRTA.

Subsequent to the decision in *Union Pacific,* the U.S. Supreme Court explicitly rejected

[1] Taxpayer also sought refunds of RRTA taxes that it paid on certain stock-based compensation (that is, gain on the exercise of non-qualified stock options and income recognized upon vesting of restricted stock and restricted stock units). The Supreme Court decided in a separate case, *Wisconsin Central Ltd. v. United States*, 138 S.Ct. 735, 856 F.3d 490 (2018), that the stock-based compensation was not taxable compensation under the RRTA.

the Eighth Circuit's premise. At issue in *BNSF Railway Company v. Loos*, 139 S.Ct. 893, 203 L.Ed.2d 160 (2019), was whether a railroad's payment to an employee for working time lost due to an on-the-job injury is subject to the RRTA.[2] Reversing the Eighth Circuit's holding that such payments are not subject to the RRTA, the Supreme Court states:

> The Eighth Circuit construed "compensation" for RRTA purposes to mean only pay for "services that an employee actually renders," in other words, pay for active service. Consequently, the court held that "compensation" within the RRTA's compass did not reach pay for periods of absence. 865 F.3d, at 1117. In so ruling, the Court of Appeals attempted to distinguish [*Social Security Board. v. Nierotko*, 327 U.S. 358 (1946)] and [*United States v. Quality Stores*, 572 U.S. 141 (2014)]. The Social Security decisions, the court said, were inapposite because the FICA "taxes payment for 'employment,'" whereas the RRTA "tax[es] payment for 'services.'" 865 F.3d, at 1117. As noted, however, [citation omitted] the FICA defines "employment" in language resembling the RRTA in all relevant respects. Compare 26 U.S.C. §3121(b) (FICA) ("any service, of whatever nature, performed . . . by an employee") with §3231(e)(1) (RRTA) ("services rendered as an employee"). Construing RRTA "compensation" as less embracive than "wages" covered by the FICA would introduce an unwarranted disparity between terms Congress appeared to regard as equivalents. The reasoning of *Nierotko* and *Quality Stores*, as we see it, resists the Eighth Circuit's swift writeoff.

139 S.Ct. at 900.

Having repudiated the premise that the RRTA applies to a narrower scope of services than the FICA, *Loos* follows *Nierotko* and its progeny by rejecting an "active service" requirement under the RRTA.[3] The Supreme Court instead holds that the determination

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[2] Under consideration in *Loos* was another Eighth Circuit opinion, 865 F.3d 1106 (8th Cir. 2017), in which the court of appeals followed its own line of analysis from the *Union Pacific* opinion at issue, rendered by the same panel earlier the same week.

[3] In addressing the ratification payments in *Union Pacific*, the Eighth Circuit declined to follow *Soc. Sec. Bd. v. Nierotko*, 327 U.S. 358, 365-66 (1946) (the very words "'any service . . . performed . . . for his employer,' with the purpose of the Social Security Act in mind import breadth of coverage") and *United States v. Quality Stores*, 572 U.S. 141, 146 (2014) (quoting *Nierotko* at 365-66, in reaffirming that "'service' includes 'not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer'"), that broadly define payment for services. 865 F.3d 1106,1117 (8th Cir. 2017). In *Loos*, however, the Supreme Court instead focuses on the holdings of *Nierotko* and *Quality Stores*, and emphasizes the parallels between the FICA and RRTA schemes.

of whether payments are compensation or wages subject to the RRTA or the FICA, as applicable, is determined by whether the "payment[s] [are] remitted to the recipient because of"[4] the employer-employee relationship:

> In line with *Nierotko*, *Quality Stores*, and the IRS's long held construction, we hold that "compensation" under the RRTA encompasses not simply pay for active service but, in addition, pay for periods of absence from active service—provided that the remuneration in question stems from the "employer-employee relationship." *Nierotko*, 327 U.S. at 366, 66 S.Ct. 637.

139 S.Ct. at 899-900.

Consistent with this broad conception of compensation for services in both the FICA and RRTA context is the courts' and IRS's position that payments arising out of ratification of a collective bargaining agreement are subject to FICA. *See* Rev. Rul. 2004-109, 2004-2 C.B. 258 ("Employment" in the FICA context "encompasses the establishment, maintenance, furtherance, alteration, or cancellation of the employee-employer relationship."); *see also STA of Balt.--ILA Container Royalty Fund v. United States*, 621 F.Supp. 1567 (D. Md. 1985), ***aff'd*** 804 F.2d 926 (4th Cir. 1986). Per *Loos*, this same analysis applies in the context of RRTA taxation.

In light of the Supreme Court's reasoning in *Loos*, the Eighth Circuit's holding in *Union Pacific* that ratification payments are not subject to the RRTA has been superseded. Accordingly, the Service will not follow the Eight Circuit's holding in *Union Pacific* regarding the RRTA taxation of ratification payments in other cases.

Recommendation: Nonacquiescence.

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[4] 139 S.Ct. at 904.

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