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# Thumbtacks in the Rocking Chair—Questionable Retirement and the Small Business Owner

*Peter J. Lemoine\**

## I. INTRODUCTION

It's a disturbing scenario—one that has occurred far too often in recent years: A business owner operates a small business establishment for a number of years. Perhaps later on, he involves a son, daughter, or significant other in the business, while gradually scaling down his involvement in day to day business operations. Through it all, however, the proprietor monitors business operations on a regular basis and continues to have a voice in major business decisions, if not the ultimate say so. Upon reaching age sixty-two or beyond, the business owner decides that the time is right to begin receiving long-awaited social security retirement benefits, paid into the system for most, if not all, of his work life. However, because the business is ongoing, he no doubt desires to continue to monitor the business as well as participate in important business decisions. But, can he do so and preserve his right to receive retirement benefits? Moreover, what result if social security retirement benefits are initiated and it is thereafter determined that the worker's involvement in the business has exceeded the bounds of "retirement" established by law? This article examines statutory and regulatory provisions, rulings, and case law dealing with the above issues and attempts to provide some measure of guidance to an area fraught with uncertainty. In addition to examining social security retirement law, this article considers the circumstances under which a self-employed individual or wage earner may be compelled to reimburse the Secretary<sup>1</sup> for benefits erroneously paid.

Attorneys, as private practitioners, should acquaint themselves with social security retirement and overpayment law for a number of reasons. First, eventually all clients will retire or semi-retire. As a client nears retirement age, few things will be as important to him, from a financial standpoint, as preserving his right to receive social security retirement benefits. If a client elects to allow the business to continue operating into his retirement years, his attorney can play a vital role by restructuring the business to allow for the client's limited participation in business operations while maintaining the client's right to receive much anticipated retirement benefits. Second, applications for retirement benefits

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1. The retirement insurance program, established under Title II of the Social Security Act, is administered by the Social Security Administration, a branch of the Department of Health and Human Services. Because the Secretary is the highest ranking official in the Department of Health and Human Services, customarily the Social Security Administration, Department of Health and Human Services is collectively referred to as "the Secretary." 42 U.S.C. §§ 401-433 (1988).

are approved more times than not without an administrative hearing. This is based in large part on the applicant's assertions as to his current and anticipated level of work activity. The absence of administrative hearings increases the likelihood of an erroneous award of benefits. This potential for erroneous awards, coupled with the fact that the amount at issue in overpayment proceedings instituted by the Secretary often ranges from \$20,000 to \$40,000, underscores the need for private practitioners to become well acquainted with social security retirement and overpayment law. This article will provide attorneys with a useful starting point when called upon to counsel or represent a client seeking retirement benefits or when defending a claim of overpayment asserted by the Secretary.

## II. ESTABLISHING ENTITLEMENT TO RETIREMENT INSURANCE BENEFITS

Pursuant to Title II of the Social Security Act (the Act), entitled "Federal Old-Age, Survivors, and Disability Insurance Benefits," Congress vested in the Secretary the authority "to make rules and regulations and to establish procedures, not inconsistent with the provisions of this subchapter."<sup>2</sup> In addition, the Act authorizes the Secretary "to make findings of fact, and decisions as to the rights of any individual applying for a payment under this subchapter."<sup>3</sup> Thus, the Secretary is vested with both legislative and adjudicatory powers in administering the benefit programs established under Title II of the Act. Pursuant to such authority, the Secretary has enacted regulations and rulings<sup>4</sup> which detail the administrative review process and articulate the circumstances under which entitlement to benefits is established.

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2. 42 U.S.C. § 405(a) (1988).

3. 42 U.S.C. § 405(b)(1) (1988).

4. While the Secretary's enacting of regulations and rulings could very well be the subject of a separate article, in general, regulations issued by the Secretary are binding upon the courts. See *Schisler v. Sullivan*, 3 F.3d 563, 567 (2d Cir. 1993) ("Judicial review of regulations promulgated pursuant to 42 U.S.C. § 405(a) is narrow and limited to determining whether they are arbitrary, capricious or in excess of the Secretary's statutory grant of authority."). Once a regulation survives this rather limited judicial scrutiny, it is binding on the courts even if it represents a departure from established case law. *Id.* at 568-69.

Social security rulings "represent precedent final opinions and orders and statements of policy and interpretations that have been adopted" and are only binding on the Secretary's adjudicative components. 20 C.F.R. § 422.406(b)(1) (1994). Hence, social security rulings are not binding on the courts. *Lauer v. Bowen*, 818 F.2d 636, 640 (7th Cir. 1987) (*per curiam*). The Secretary has the authority to issue rulings which are of limited geographical application. 20 C.F.R. § 404.985(b) (1994) provides that where a:

United States Court of Appeals holding conflicts with our interpretation of a provision of the Social Security Act or regulations . . . we will issue a Social Security Acquiescence Ruling that describes the administrative case and the court decision, identifies the issue(s) involved, and explains how we will apply the holding, including, as necessary, how the holding relates to other decisions within the applicable circuit.

*Id.* Thus, acquiescence rulings, unlike other rulings, only have circuit-wide application.

To establish entitlement to retirement benefits, the worker must show (1) he is age 62 or older<sup>5</sup> and (2) he has enough quarters of coverage to be fully insured.<sup>6</sup> The burden of proof rests with the individual seeking benefits.<sup>7</sup> In order to achieve fully insured status, the worker must have one quarter of coverage for each calendar year after 1950 or, if later, for each calendar year after the year the worker becomes age 21.<sup>8</sup> A quarter of coverage is a basic unit of coverage credited on the basis of the amount of earnings received by a worker during a given period.<sup>9</sup> If an individual, otherwise qualified to receive benefits under the criteria noted above, continues to receive income attributable to work activity, the regulations mandate certain deductions be made once earnings exceed the applicable exempt amount.<sup>10</sup> Except in those instances hereafter discussed, the exemptions that apply are the annual, not monthly, exempt amounts provided in the regulations.<sup>11</sup> The annual and, where applicable, monthly exempt amounts for each calendar year are calculated in accordance with a rather complex formula provided in the Act<sup>12</sup> and are published in the Federal Register on or before November 1 of each year.<sup>13</sup> For individuals who have attained retirement age, excess earnings for taxable years beginning after December 31, 1989, are thirty-three and one-third percent of all earnings which

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5. 20 C.F.R. § 404.310(a) (1994).

6. 20 C.F.R. § 404.310(b) (1994).

7. 20 C.F.R. § 404.704 (1994).

8. 20 C.F.R. § 404.110(b)(2) (1994).

9. 20 C.F.R. § 404.140(a) (1994). 20 C.F.R. § 404.140(b) (1994) provides that for years prior to 1978, quarters of coverage are credited on a quarterly, as opposed to annual, basis. Thus, if earnings received during a quarter before the year 1978 exceed the amount necessary to establish a quarter of coverage, the balance cannot be applied to another quarter. 20 C.F.R. § 404.140(c) (1994) states that from 1978 onward, wages and self-employment income are credited on an annual basis, and the worker is accordingly credited with a quarter of coverage for each part of his earnings in a calendar year "that equals the amount required for a QC [quarter of coverage] in that year." 42 U.S.C. § 413(d)(1) (1988) provides that the amount of wages and self-employment income necessary to establish a quarter of coverage "shall be \$250 in the calendar year 1978 and the amount determined under paragraph (2) of this subsection for years after 1978." In addition to setting forth the formula for computing quarters of coverage after 1978, 42 U.S.C. § 413(d)(2) (1988) requires the Secretary to "publish in the Federal Register the amount of wages and self-employment income which an individual must have in order to be credited with a quarter of coverage in the succeeding calendar year." This figure has risen from \$260 in 1979 to \$630 in 1995. 43 Fed. Reg. 53,504 (1978); 59 Fed. Reg. 54,465 (1994).

10. Note, however, that workers age 70 or older are entitled to full retirement benefits regardless of the amount of their earnings. 20 C.F.R. § 404.415(a) (1994).

11. 20 C.F.R. § 404.430(a)-(b) (1994).

12. 42 U.S.C. § 403(f)(8)(B) (1988). For individuals ages 65-69, the annual exempt amount is \$9,720 for 1991, \$10,200 for 1992, \$10,560 for 1993, \$11,160 for 1994, and \$11,280 for 1995. For individuals ages 62-64, the annual exempt amount is \$7,080 for 1991, \$7,440 for 1992, \$7,680 for 1993, \$8,040 for 1994 and \$8,160 for 1995. 56 Fed. Reg. 55,327 (1991); 58 Fed. Reg. 58,006 (1993); 59 Fed. Reg. 54, 467 (1994).

13. 42 U.S.C. § 403(f)(8)(A) (1988).

are above the exempt amount.<sup>14</sup> For individuals of early retirement age as well as retirement age individuals for taxable years beginning prior to December 31, 1989, excess earnings are fifty percent of all earnings above the applicable exempt amount.<sup>15</sup>

Excess earnings, computed as the above, reduce benefits on a dollar for dollar basis.<sup>16</sup> Thus, \$50 of excess earnings will reduce benefits by \$50. Excess earnings are charged to each month beginning with the first month of entitlement and continuing to each subsequent month until all excess earnings have been charged.<sup>17</sup>

While the annual exempt amounts are generally applicable, the worker is given a break during the so-called "grace years." In a grace year, the monthly exempt amounts provided in the regulations apply.<sup>18</sup> Hence, the worker is entitled to full retirement benefits for all months in which his earnings do not exceed such amount.<sup>19</sup> Thus, the worker can draw full benefits during these months, notwithstanding the fact that his annual earnings may ultimately exceed the annual exempt amount. This grace period can prove to be a substantial benefit, particularly during the individual's initial year of retirement. For example, if an individual retires in April and his year-to-date earnings exceed the annual exempt amount, he can nevertheless draw full benefits for the balance of the year provided his monthly earnings during such period do not exceed the monthly exempt amount. For wage earners applying for retirement benefits, the first year, after entitlement is established,<sup>20</sup> in which earnings fall below the monthly exempt amount for at least one month is considered a grace year.<sup>21</sup> A self-employed individual is entitled to a grace year during the first year in which he has not engaged in "substantial services" for at least one month.<sup>22</sup> In determining whether or not a self-employed individual has engaged in "substantial services," the multi-factored test provided by the regulations is applied.<sup>23</sup>

Finally, the regulations provide that only income attributable to "significant services" counts in determining one's entitlement to retirement benefits.<sup>24</sup>

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14. 20 C.F.R. § 404.430(a) (1994).

15. *Id.*

16. 20 C.F.R. § 404.434(b) (1994).

17. 20 C.F.R. § 404.434(a) (1994).

18. 20 C.F.R. § 404.430(b) (1994).

19. 20 C.F.R. § 404.435(a)(7) (1994).

20. See *supra* notes 5 and 6 and accompanying text for explanation of how entitlement to benefits is established.

21. 20 C.F.R. § 404.435(b)-(c) (1994).

22. 20 C.F.R. § 404.435(b)-(d) (1994).

23. 20 C.F.R. §§ 404.446-404.447 (1994) provide that the following are the primary factors to be considered in determining whether or not an individual is performing substantial services: (a) time devoted to the business, (b) nature of services performed, (c) extent and nature of work activity performed before the alleged date of retirement as compared with that performed subsequent thereto, (d) presence or absence of an employee charged with the management of the business, (e) amount of capital invested in the business, and (f) nature of the business as seasonal.

24. 20 C.F.R. § 404.429(b)(2)(ii) (1994).

“Significant services” are defined by regulation as “any significant activity performed by the individual in the operation or management of a trade, profession, or business which can be related to the income received.”<sup>25</sup> Section 404.429(b)(2)(ii) provides that the following activities are *not* considered to be “significant services”:

- (1) Activities in connection with the selling of a product or crop produced or created prior to the first month of benefit entitlement;
- (2) Hiring an agent, manager or other employee to operate the business;
- (3) Signing contracts where the signature of the owner of the business is required;
- (4) Looking over the financial records to assess employee performance;
- (5) Personally contacting old and valued customers in order to maintain goodwill, provided such contact has a minimal effect on ongoing business operations;
- (6) Occasionally filling in for an agent or employee in an emergency.<sup>26</sup>

Note, however, that the regulations establish a rebuttable presumption that all income attributable to work activity is countable for purposes of determining benefit entitlement.<sup>27</sup>

#### A. *Income Shifting*

A look at how the courts have handled questionable retirement issues will facilitate a better synthesis of these concepts. In *Gardner v. Hall*,<sup>28</sup> Hall, his wife, and three adult children operated a family ranching business as a partnership.<sup>29</sup> While each partner owned a one-fifth interest in the business, none of the partners drew a salary for services rendered. In December of 1960, the business was incorporated, and each of the partners received one-fifth of the issued stock. Hall assumed the position of president, his wife was appointed secretary-treasurer, and their three sons were named as vice-presidents. While Hall received no salary as president, his wife and three sons were each paid an annual salary of \$12,000 for duties performed as officers of the corporation. The record reflects that after the business was incorporated, Hall worked approximately two to three hours per day, mostly giving advice to family members. Hall's wife worked twice that amount. The evidence also establishes that Mrs. Hall deposited her salary in a joint checking account maintained by her and her

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25. *Id.*

26. 20 C.F.R. § 404.429(b)(2)(ii) (1994).

27. 20 C.F.R. § 404.429(b)(2)(iii) (1994).

28. 366 F.2d 132 (10th Cir. 1966).

29. 366 F.2d at 133.

husband and that some of the household expenses were paid from this account.<sup>30</sup>

Hall's application for retirement benefits, filed after the business was incorporated, was denied through the appeals council level.<sup>31</sup> Subsequently, however, the district court reversed, and the Secretary appealed to the Eleventh Circuit.<sup>32</sup> On appeal, the Secretary advanced two arguments in support of the denial of benefits. First, the Secretary contended that since Hall devoted about one-half as much time to the business as his wife, who received an annual salary of \$12,000, it was reasonable to assume that his services were worth at least \$6,000. Thus, reallocation of this amount to Hall extinguished any entitlement to benefits during the period in question. Second, the Secretary maintained that undistributed corporate profits of an unspecified sum, but presumably enough to preclude benefit entitlement, should be allocated to Hall as reimbursement for services performed in view of the fact that such income was, in large part, attributable to his efforts.

In rejecting the Secretary's first argument, the Eleventh Circuit observed that the Secretary unquestionably has the authority to vitiate fictitious salary arrangements and reallocate wages between parties to reflect the realities of the business.<sup>33</sup> The court noted, however, that the Secretary can only exercise such authority in situations in which the evidence establishes the existence of a scheme of shifting wages from one party to another.<sup>34</sup> Since no evidence in the record suggested that Mrs. Hall or her three sons were not worthy of their respective salaries, the court found that the evidence did not establish that wages

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30. 366 F.2d at 134.

31. 366 F.2d at 133.

32. The administrative review process is initiated by the filing of an application for benefits. At the first step of the review process, the Secretary's adjudicative component makes a determination without a hearing. If the claim is denied, the aggrieved party has the right to request a reconsideration, at which time the Secretary reconsiders the original determination, again without hearing. The third step in the process is the administrative law judge hearing. At this *de novo*, non-adversary hearing, the applicant has the right to have an attorney or qualified non-attorney serve as a legal representative. If the individual is dissatisfied with the administrative law judge's determination, he may then request review by the Appeals Council, a centrally located appellate body responsible for reviewing administrative law judge decisions for, among other things, abuse of discretion, error of law, and error of fact. The Appeals Council will not disturb factual findings of the administrative law judge if supported by substantial evidence. Substantial evidence is defined as such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. *Richardson v. Perales*, 402 U.S. 389, 91 S. Ct. 1420 (1971). If the Appeals Council denies the request for review or affirms the decision of the administrative law judge upon review, the decision becomes the final decision of the Secretary, and the individual has sixty days to institute an action in federal district court. 20 C.F.R. §§ 404.900-404.982 (1994). The district court will not overturn findings of fact if supported by substantial evidence. 42 U.S.C. § 405(g) (1988). Unlike the Secretary's factual findings, conclusions of law are subject to independent review by the district court and are therefore not presumed valid. *Smith v. Schweiker*, 646 F.2d 1075 (5th Cir. 1981).

33. 366 F.2d at 135.

34. *Id.*

were improperly diverted or shifted by Hall to another individual.<sup>35</sup> This being the case, the court held the Secretary had no authority to vitiate the corporation's salary arrangements even though the value assigned by the Secretary to the services rendered by Hall was supported by the evidence.<sup>36</sup> Finally, the court summarily rejected the Secretary's contention that a portion of undistributed corporate profits should be reclassified as wages and allotted to Hall. The court noted that while the Internal Revenue Service has the authority to reclassify and constructively allocate undistributed corporate income, the Secretary was not vested with such plenary authority by Congress.<sup>37</sup> Thus, finding neither of the Secretary's arguments submitted on appeal meritorious, the Eleventh Circuit affirmed the district court's judgment in favor of Hall.<sup>38</sup>

*Gardner* left open the question of whether the Secretary has the authority to reclassify distributed corporate profits as wages for purposes of determining benefit entitlement. The Eighth Circuit, however, resolved this issue in favor of the Secretary in *Ludeking v. Finch*.<sup>39</sup> *Ludeking* challenged the Secretary's authority to reclassify as wages dividends paid by a Subchapter S corporation, contending that the exercise of such authority defeats the purposes of Subchapter S of the Internal Revenue Code. The court made short work of this argument, noting that the underlying purpose of Subchapter S is to allow business owners to choose the protection of a corporate structure while avoiding what is often perceived as prohibitive double taxation.<sup>40</sup> Subchapter S, the court noted, therefore deals with the treatment of income "and is not at all concerned with what constitutes income, wages or salary under the Social Security Act."<sup>41</sup> Hence, the policy considerations underlying the enactment of Subchapter S, observed the Eighth Circuit, are in no way contravened by its recognition of the Secretary's authority to reclassify dividend income as wages.<sup>42</sup> Thus, the court found that if, as here, a business owner has in fact received dividend income in exchange for services rendered, and the dividend income is, therefore, in the nature of disguised wages, the Secretary has the authority to reclassify dividends as earned income for purposes of determining entitlement to retirement benefits.<sup>43</sup> Interestingly, the court also noted in dictum that under no circumstances does the Secretary have the authority to reclassify undistributed corporate income as earned income for purposes of determining entitlement to retirement benefits. Nevertheless, *Ludeking* goes a step beyond *Gardner* because *Ludeking* holds that the authority of the Secretary to vitiate fictitious income arrangements

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35. *Id.*

36. 366 F.2d at 135-36.

37. *Id.*

38. 366 F.2d at 136.

39. 421 F.2d 499 (8th Cir. 1970).

40. 421 F.2d at 503.

41. *Id.*

42. 421 F.2d at 503-04.

43. 421 F.2d at 503.



is not limited to those situations in which a scheme of shifting wages is established.

*B. The Heer Factor*

*Heer v. Secretary of Health and Human Services*<sup>44</sup> is an important Sixth Circuit decision dealing with questionable retirement issues. Heer and his wife were the only shareholders, directors, and officers of a closely held corporation. From 1972 until his alleged retirement in 1978, Heer served as president and secretary at an annual salary of \$53,260, while his wife earned \$26,630 as vice-president and treasurer. Corporate minutes reflect that in November of 1977, Heer's wife was elected to serve as president of the corporation at Heer's former salary while Heer continued to serve as secretary without compensation. Four months later, Heer filed an application for retirement benefits.<sup>45</sup>

In denying benefits, the Secretary pointed out that the salary received by Heer's wife was his sole source of income and was undoubtedly used for his support. The Secretary additionally noted that neither Heer's duties nor his wife's duties had changed appreciably subsequent to their exchange of corporate titles. Thus, the reasonable value of the services Mrs. Heer performed for the corporation as president was the amount of her former salary; therefore the balance should be allocated to Heer for purposes of determining benefit entitlement. Because such allocation exceeded the maximum allowed by law,<sup>46</sup> the Secretary determined that Heer was not entitled to retirement benefits.<sup>47</sup>

In reviewing the Secretary's denial of benefits, the Sixth Circuit initially recognized the authority of the Secretary, under the Act and the regulations, to conduct a substance over form analysis of business transactions and relationships for purposes of determining entitlement to retirement insurance benefits.<sup>48</sup> The court also agreed with the Secretary that the following are among "several" factors to consider before piercing the veil of fictitious salary arrangements:

- (1) Does the individual claiming benefits continue to contribute substantial and valuable services to the corporation?
- (2) Has a family member received an increase in salary with no commensurate increase in duties?
- (3) Is the income of such family member used to support the individual claiming benefits?<sup>49</sup>

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44. 670 F.2d 653 (6th Cir. 1982) (per curiam).

45. 670 F.2d at 654-55.

46. The terms "exempt amount" and "maximum allowed by law" have different meanings. The "exempt amount" refers to the maximum amount of earnings an individual can receive without incurring a reduction in benefits. Earnings are said to equal the "maximum allowed by law" when they reduce benefit entitlement to zero.

47. 670 F.2d at 655.

48. *Id.*

49. *Id.*

Without making a specific finding regarding any of the factors noted above, the court found the record supported the Secretary's determination that the reduction in Heer's salary and contemporaneous increase in his wife's salary constituted a fictitious salary arrangement.<sup>50</sup> The court, therefore, affirmed the Secretary's denial of benefits, finding the "reallocation" by the Secretary of "part" of the wife's salary to Heer was justified.<sup>51</sup>

Importantly, however, the *Heer* court did not find that all three of the factors discussed above must exist before the Secretary may vitiate a fictitious salary arrangement. The Sixth Circuit simply stated these were three of "several" factors to be considered before piercing the veil of unrepresentative salary arrangements.

### C. *Conflicting Standards for Vitiating Salary Arrangements*

As stated earlier, the Secretary will from time to time promulgate rulings which are only binding on the Secretary's adjudicative components.<sup>52</sup> In many instances, the Secretary will simply adopt as a ruling a circuit court decision, thus giving the decision nationwide application. The Secretary, in one such instance, adopted the ruling of *Berger v. Secretary of Health and Human Services*,<sup>53</sup> promulgated as S.S.R. 88-12c.<sup>54</sup> In *Berger*, the Sixth Circuit engaged in a well-thought out analysis of the applicable statutory and regulatory provisions and ultimately concluded that benefit entitlement had not been established. The facts revealed that Berger was originally awarded retirement benefits in August of 1978 based on her assertion that she worked, and would continue to work, only on weekends in a family-owned jewelry business. Thereafter, in August of 1984, Berger went to the Social Security district office to seek an increase in benefits. At that time, she completed a standard information form, stating that she worked an average of fifty-one hours per week and further asserting that her duties had not changed since 1978.<sup>55</sup>

Upon receiving the above information, the Secretary determined that although Berger had been paid a salary of only \$50 per week from 1978 onward, the *actual* value of the services she rendered to the business during this period was in excess of the maximum allowed by law. The Secretary, therefore, determined that Berger had erroneously been paid retirement benefits totalling \$29,458.90. The Secretary's initial determination of overpayment was appealed by Berger, and the decision was affirmed on reconsideration. Subsequently, an administrative law judge heard the case. The administrative law judge noted that prior to her alleged retirement in 1978, Berger and her husband each earned

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50. 670 F.2d at 655-56.

51. 670 F.2d at 656.

52. See *supra* note 4 and accompanying text.

53. 835 F.2d 635 (6th Cir. 1987).

54. S.S.R. 88-12c (cum. Ed. 1988).

55. 835 F.2d at 637.

approximately \$20,800 per year. Immediately thereafter, however, Berger's annual salary was reduced to a mere \$2600 while her husband's salary was increased to \$80,000 per year, although the time devoted to the business and duties performed by both parties never changed.<sup>56</sup> Considering these facts, the administrative law judge concluded Berger's services had a value of one-half of the combined wages paid to her and her husband during the years 1978 through 1983.<sup>57</sup> Because Berger's allocated earnings for these years extinguished any right to retirement insurance benefits, the administrative law judge affirmed the previous finding that she had been overpaid benefits totalling \$29,458.90 during the period in question.<sup>58</sup>

In reviewing the administrative law judge's decision, the court in *Berger* recognized at the outset the right of the Secretary to examine the substance of business transactions in order to determine if the individual claiming benefits is in fact retired under the Act and regulations.<sup>59</sup> In valuing services performed, the court noted that consideration must be given to the following factors:

- (1) time devoted to the business;
- (2) nature of services rendered;
- (3) comparison of extent and nature of activity performed before and after the alleged date of retirement;
- (4) presence of an adequately qualified paid individual managing the business (in place of the individual alleging retirement);
- (5) type of business involved;
- (6) amount of capital invested in the business;
- (7) seasonal nature of the business.<sup>60</sup>

Having said this, the court held, after carefully reviewing the record, that substantial evidence did not support the administrative law judge's determination that the services rendered by Berger and her husband during the years in question were of equal value.<sup>61</sup> The court noted Berger's husband was the manager and the driving force of the business. Consequently, his services were clearly of greater value than those performed by his wife.<sup>62</sup> Nevertheless, the court concluded Berger's services were assuredly worth at least one-fourth of the combined income of such parties, considering her efforts in sales, supervision, and management. The court, therefore, allocated earnings in this amount to

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56. 835 F.2d at 637-38.

57. These values were \$51,600 in 1978, \$41,600 in 1979, \$41,600 in 1980, \$50,000 in 1981, \$52,900 in 1982, and \$55,400 in 1983. 835 F.2d at 638.

58. 835 F.2d at 638.

59. 835 F.2d at 639.

60. *Id.* The court "borrowed" these factors from 20 C.F.R. § 404.446(a) (1994) which, as previously noted, only applies where entitlement to a grace year is at issue. See *supra* note 23 and accompanying text.

61. *Id.*

62. *Id.*

Berger for purposes of determining benefit entitlement.<sup>63</sup> Because Berger's allocated earnings exceeded the maximum allowed by law during the period in question, the Sixth Circuit affirmed the Secretary's conclusion that Berger was not entitled to retirement benefits during the years 1978-1983 and affirmed the Secretary's resultant determination of overpayment.<sup>64</sup>

In affirming the Secretary's determination of overpayment, the court rejected two rather interesting procedural arguments raised by Berger. First, Berger contended the administrative review process was unfair because the 1984 information form she executed in connection with a request for increased benefits was used against her to assess the overpayment without prior warning. In resolving this issue in favor of the Secretary, the court noted that because Berger had voluntarily entered the social security office seeking an increase in benefits, the Secretary was authorized to elicit all information necessary to process the request.<sup>65</sup> As for Berger's contention that prior notice of the form's potential use should have been given, the court determined the Secretary was "under no obligation to warn Mrs. Berger that her admissions might be used to determine that she was not retired during the years she claimed she was."<sup>66</sup> In so holding, the court essentially rejected the notion that the administrative review process was a quasi-criminal proceeding mandating something in the nature of a *Miranda* warning prior to eliciting relevant information in connection with a claim for benefits. Second, Berger contended she was denied due process because the administrative law judge rejected her request to subpoena the employee who initially assessed the overpayment on behalf of the Social Security Administration. The court disagreed, finding the determination as to whether a subpoena is reasonably necessary is reserved by regulation<sup>67</sup> to the administrative law judge, and such a procedure does not violate due process.<sup>68</sup>

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63. 835 F.2d at 639-40.

64. 835 F.2d at 640-41.

65. 835 F.2d at 640.

66. *Id.*

67. 20 C.F.R. § 404.950(d) (1994) provides when "reasonably necessary," the administrative law judge may issue a subpoena for the appearance and testimony of witnesses or production of books, papers, or other documents.

68. 835 F.2d at 640-41. This finding is questionable in light of the Supreme Court's decision in *Richardson v. Perales*, 402 U.S. 389, 91 S. Ct. 1420 (1971). The court in *Perales* held that in a Title II claim for disability insurance benefits, due process mandates that the benefit applicant be afforded the right to cross examine physicians whose reports are to be considered by an administrative law judge in determining the issue of disability. *Id.* at 409-10, 91 S. Ct. at 1431-32. See also *Lidy v. Sullivan*, 911 F.2d 1075 (5th Cir. 1990), *cert. denied*, 500 U.S. 959, 111 S. Ct. 2274 (1991). The findings made at the initial and reconsideration levels of the administrative review process in overpayment proceedings are considered as evidence the same as reports submitted by examining or treating physicians in Title II disability claims. One might therefore argue that the right to cross examine employees of the Social Security Administration involved in the decision making process in an overpayment proceeding is analogous to the right to confront and examine reporting physicians in Title II claims for disability insurance benefits.

In *Martin v. Sullivan*,<sup>69</sup> adopted by the Secretary as S.S.R. 91-1c,<sup>70</sup> Martin worked as a self-employed musician, and his wife handled the clerical aspects of the business. Martin did not dispute that in September of 1982 he incorporated the business for the specific purpose of obtaining retirement insurance benefits. Martin was named as president of the corporation, while his wife was named secretary-treasurer. Martin and his wife each were issued one-half of the corporate stock, and both were appointed to serve on the board of directors. However, the duties performed by Martin and his wife did not change after the business was incorporated.

In his original application for retirement benefits filed in September of 1983, Martin claimed he would be "retired" as of January 1, 1984.<sup>71</sup> He asserted that as of such date his monthly earnings would be reduced to \$430 per month. Although he would continue to make all major business decisions, the amount of time he planned to devote to the business would decrease significantly. Martin also claimed that, as of such date, his wife would handle bookings but that he would retain the right to accept or reject all engagements. Despite these assertions, the Secretary denied Martin's application for benefits in October of 1983, finding that the record did not support his claim of "anticipated retirement." No appeal was filed. Martin, however, filed a second application for benefits in January of 1984 which was denied both initially and on reconsideration. Martin then requested an administrative law judge hearing and amended his alleged onset of retirement to January 1, 1985. At the administrative law judge hearing, Martin acknowledged that he continued to manage the business, which included making major business decisions and setting salaries, and stated the amount of time he spent performing such duties ranged from five to ten hours per week.<sup>72</sup> However, in addition to the time spent managing the business, he stated that he played music approximately twenty-five to thirty hours per month. He further stated that even after the business was incorporated in 1982, his wife's duties continued to be primarily clerical in nature. Fiscal year 1983 records revealed gross receipts of \$236,742, with Martin receiving wages totalling \$7,200 while his wife was paid a salary of \$16,800. Records for fiscal year 1984 revealed gross receipts of \$213,142 with an annual salary of \$4,050 being paid to Martin and \$9,250 being paid to Martin's wife.

Relying on Sections 404.704-.709, the Eleventh Circuit correctly noted that in questionable retirement cases, the burden of proof rests with the individual claiming entitlement to benefits, and accordingly, such person must demonstrate that his earnings do not exceed the maximum allowed by law.<sup>73</sup> The court also emphasized that the adjudicator must closely scrutinize the affairs of a family operated business when it is evident that the business has been restructured for

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69. 894 F.2d 1520 (11th Cir. 1990).

70. S.S.R. 91-1c (cum. Ed. 1990-91).

71. 894 F.2d at 1522.

72. 894 F.2d at 1525.

73. 894 F.2d at 1531-32.

the express purpose of obtaining retirement insurance benefits.<sup>74</sup> Turning its attention to the facts of the case, the court concluded the following findings of the Secretary were supported by substantial evidence:

A. That Mrs. Martin's duties remained unchanged since the business was incorporated in 1982 and it was therefore clear that the increases in salary received by her were not attributable to an increase in duties performed.<sup>75</sup>

B. That Mrs. Martin's salary was undoubtedly used to provide for Martin's support.<sup>76</sup>

C. That at all times pertinent hereto, Martin retained "active control" of the business and thus, he continued to be significantly involved in the affairs of the business subsequent to his alleged retirement.<sup>77</sup>

D. That the compensation received by Martin was not representative of the services he rendered to the business.<sup>78</sup>

In view of these findings, the court concluded that substantial evidence clearly supported the Secretary's refusal to accept Martin's allegations of significantly decreased work activity and assumption of increased duties by his wife. The court noted that, in essence, the shifting of salaries and corporate titles were changes of form rather than substance.<sup>79</sup> The court went on to assail the scheme devised by Martin as a "blatant example" of a fictitious family salary arrangement not at all in keeping with the realities of the business.<sup>80</sup>

After analyzing the jurisprudence dealing with questionable retirement issues, the court endorsed the three-factor analysis discussed in *Heer*.<sup>81</sup> However, while *Heer* simply held that among "several" factors to consider in assessing benefit entitlement were continued performance of "substantial and valuable services" by the benefit applicant, receipt by a family member of unwarranted salary increases, and use of the family member's income to support the individual claiming benefits,<sup>82</sup> *Martin*, through its endorsement of *Taubenfeld v. Bowen*,<sup>83</sup> implicitly holds that all three of these factors must be present before the Secretary may pierce the veil of fictitious income arrangements.<sup>84</sup> Stated another way, *Martin* holds that unless the evidence demonstrates the existence of a scheme of shifting wages to another individual through which the

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74. 894 F.2d at 1532.

75. 894 F.2d at 1530.

76. 894 F.2d at 1533.

77. *Id.*

78. 894 F.2d at 1530.

79. *Id.*

80. 894 F.2d at 1533.

81. 894 F.2d at 1532. See *supra* text accompanying note 49.

82. See *supra* text accompanying note 49.

83. 685 F. Supp. 237 (S.D. Fla. 1988).

84. 894 F.2d at 1533.

benefit applicant derives support, the Secretary has no authority to vitiate a fictitious income arrangement. Entitlement to benefits must, therefore, be judged on the basis of the earned income claimed by the individual seeking benefits. Having concluded that substantial evidence supported the Secretary's determinations with respect to each of the three factors discussed in *Heer*, the Eleventh Circuit affirmed the Secretary's denial of Martin's application for retirement insurance benefits.<sup>85</sup>

In *Rand v. Sullivan*,<sup>86</sup> Rand and his wife were the sole shareholders in International Foods of America, a food brokerage business operated out of their home.<sup>87</sup> While both parties worked in the business, prior to 1979, Rand devoted more time to the business than his wife. In July of 1979, Rand, having reached age sixty-five and being in ill health, applied for and subsequently began receiving monthly retirement benefits. The record reflects that Rand continued to work in the business subsequent to his alleged retirement at a reduced salary of \$400 per month. His wife's salary, on the other hand, grew considerably, increasing from \$22,900 in 1979 to \$49,000 by 1983. In 1984, having reached the age of sixty-five, Rand's wife applied for retirement benefits. By this time, Rand had reached age seventy and therefore, was not subject to any reduction in retirement benefits based on earned income.<sup>88</sup> In her application for benefits, Rand's wife claimed to have turned over control of the business to her husband whose health had since improved.

The Secretary, suspecting the Rands had engaged in a scheme of wage shifting in order to recover benefits, opened an investigation and determined Rand in fact had never retired within the meaning of the Act and regulations and had, therefore, been overpaid benefits from 1979 to 1984. The Secretary's initial determination of overpayment was affirmed on reconsideration and thereafter by the administrative law judge.<sup>89</sup> On review, the Appeals Council found the services performed by the Rands from 1979 to 1984 were of equal value and allocated one-half of the total wages received by the parties during the years in question to Rand. Since the value of Rand's services and resultant wage allocation exceeded the maximum allowed by law, the Appeals Council upheld the previous determination that Rand had erroneously been paid retirement benefits during the years in question.

In affirming, the Ninth Circuit initially pointed out that, contrary to the assertions made by Rand, the Secretary did not question the time he devoted to the business or the nature of the services performed.<sup>90</sup> The court observed the Secretary based her decision on her determination that the nominal salary

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85. *Id.*

86. 924 F.2d 159 (9th Cir. 1990).

87. 924 F.2d at 160.

88. *See supra* note 10.

89. 924 F.2d at 161.

90. 924 F.2d at 161. *See infra* note 93.

received by Rand was not representative of the services he performed.<sup>91</sup> The court then concluded the Secretary's allocation of earnings and determination of overpayment were supported by substantial evidence.<sup>92</sup> In affirming the determination of overpayment, the Ninth Circuit relied upon the Rands' testimony as to their respective duties, and the circumstances surrounding Rand's retirement for medical reasons and Rand's subsequent recovery, and statements from four of Rand's customers, all of whom maintained they were unaware of any change in the management of the business during the years 1979-1984.<sup>93</sup>

*Roper v. Secretary of Health and Human Services*<sup>94</sup> and *Taubenfeld v. Bowen*<sup>95</sup> are two district court decisions worthy of discussion. In *Roper*, the Secretary determined the claimant, Roper, was obligated to repay retirement benefits received during the years 1983-1985, totalling \$13,739 based on her determination that during this period Roper's allocated earnings exceeded the maximum allowed by law.

Roper applied for retirement benefits in August of 1983 and was awarded benefits effective December of 1983. The record reflects that during the period in question Roper's wife and son were the owners of 100% of the outstanding stock in an incorporated business known as S. Roper Co. while Roper was the sole shareholder of Real Care, Inc., a Subchapter S corporation organized to provide administrative services to S. Roper Co. Although Roper conceded he spent an average of seven to seven and one-half hours per day on the premises of either business, he maintained he was not always engaged in company business. Roper claimed no earned income in 1983. In 1984, he claimed wages from Real Care, Inc. of \$5,000, and in 1985, he claimed wages from Real Care, Inc. of \$4,000. Roper, therefore, drew no salary from S. Roper Co. He contended he did not draw a larger salary from Real Care, Inc. because the corporation was financially unable to pay him any more money during this period.

In deciding against Roper, the administrative law judge noted Roper's salary was not representative of the value of services performed, pointing out that Roper provided much of the managerial expertise and made most of the major business decisions for both corporations.<sup>96</sup> The administrative law judge reasoned it was most unlikely that someone with Roper's experience and background would perform services for such nominal wages had he and his family not owned the corporations involved. The administrative law judge further observed that S. Roper Co. and Real Care, Inc. profited from Roper's

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91. 924 F.2d at 161.

92. *Id.*

93. *Id.* Interestingly, the court went to great lengths to point out that Rand's assertions as to the type and amount of work performed were not being questioned, even though the evidence relied upon by the Ninth Circuit did, in some respects, contradict Rand's testimony on such issues.

94. 769 F. Supp. 243 (N.D. Ohio 1990).

95. 685 F. Supp. 237 (S.D. Fla. 1988).

96. 769 F. Supp. at 246.



willingness to accept below-standard compensation in an amount equal to the difference between the value of services rendered and the amount of compensation paid. Furthermore, because Roper owned all of the stock in Real Care, Inc. and his wife and son owned all of the stock in S. Roper Co., Roper derived a benefit identical to that received by such corporations. Thus, the administrative law judge concluded the value of services rendered, rather than earned income reportedly received, was the determining factor in assessing benefit entitlement. Finding such value to be in excess of the maximum allowed by law during the years in question, the administrative law judge concluded Roper was not entitled to benefits during such period and was, therefore, overpaid a total of \$13,739.

Citing Section 403(f)(4)(A) and (B) as its authority in reviewing the Secretary's findings, the district court noted that the wages of individuals claiming benefits are presumed by law to be in excess of the applicable exempt amount.<sup>97</sup> Turning its attention to the facts, the court agreed with the magistrate's determination that Real Care, Inc. and S. Roper Co. were separate, distinct, legitimate, and active business concerns.<sup>98</sup> Additionally, the court noted that absent a specific finding that Roper had received some form of "hidden income," the Secretary was without the authority to allocate additional income to him for purposes of determining benefit entitlement.<sup>99</sup> Finding the earned income received by Roper during the years in question to be below the applicable exempt amounts and finding "no evidence of any irregularities in the structuring of the corporations or of Roper converting, diverting, or shielding income,"<sup>100</sup> the court reversed the Secretary's determination that Roper had been overpaid retirement benefits during the years in question.<sup>101</sup>

In *Taubenfeld v. Bowen*,<sup>102</sup> Taubenfeld filed an application for retirement benefits in August of 1984, alleging retirement as of April of 1984 from Kontrol Menswear Corporation, Inc., a small family-operated business. At such time, he resigned as president, relinquished control of daily business operations, and reduced his involvement from two hundred to seventy-two hours per month. Taubenfeld asserted in his application for benefits that his wife and two sons had assumed the majority of his prior duties and in consideration thereof had received substantial wage increases. Taubenfeld's annual salary, on the other hand,

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97. The court clearly misplaced its reliance on 42 U.S.C. § 403(f)(4)(A)-(B) (1988). These provisions only apply if entitlement to a grace year is at issue. Nevertheless, as noted previously, the individual alleging entitlement to benefits does have the burden of proving all facts necessary to establish entitlement. 20 C.F.R. § 404.704 (1994). See *supra* note 7 and accompanying text.

98. 769 F. Supp. at 248.

99. *Id.*

100. 769 F. Supp. at 248-49.

101. 769 F. Supp. at 249. Ironically, as the administrative law judge pointed out in his reasons for decision, Roper *did* in fact receive hidden income because as the sole shareholder in Real Care, Inc., he directly profited from his willingness to accept below-standard wages, as did his family members who owned all of the stock in S. Roper Co.

102. 685 F. Supp. 237 (S.D. Fla. 1988).

dropped from \$32,000 to \$6,960 at the time of his alleged retirement in April of 1984. He also reported wages for 1985 totalling \$7,320.

Taubenfeld's application for benefits was denied through the Appeals Council level. In affirming the administrative law judge's denial of benefits, the Appeals Council pointed out that Taubenfeld continued to perform duties vital to the success of the business including customer solicitation and the making of important business decisions. The Appeals Council also noted that corporate tax returns for 1983 and 1984 revealed that Kontrol Menswear Corporation, Inc. maintained substantial undistributed corporate earnings which Taubenfeld had the ability to pay to himself at anytime. These earnings, the Appeals Council concluded, could be constructively allocated to Taubenfeld to reflect the reasonable value of his services, it being the opinion of the Appeals Council that Taubenfeld's declared salary for 1984 and 1985 did not reflect his worth to the business. The Appeals Council then concluded, for purposes of determining entitlement to benefits, that Taubenfeld's earned income consisted of his stated salary together with retained earnings of an amount equal to his ownership interest in the business, twenty-four and one-half percent of outstanding stock in 1984 and twenty-seven percent of outstanding stock in 1985. The combination of these figures, the Appeals Council reasoned, represented the reasonable worth of services performed by Taubenfeld during the years in question. In that Taubenfeld's actual and "imputed wages" exceeded the maximum allowed by law, his claim for benefits was, in the opinion of the Appeals Council, properly denied.

In reversing the Secretary's determination, the district court acknowledged Taubenfeld had clearly rearranged his business affairs in order to qualify for retirement benefits, correctly pointing out that he was free to do so as long as he was "legitimately retired and the arrangement was bona fide."<sup>103</sup> Citing the three-point analysis discussed in *Heer* as the applicable standard, the court went on to conclude that unless *all* three factors are shown to exist, the Secretary cannot treat the salary arrangement of a business as a "sham" or "scheme of shifting wages."<sup>104</sup> Applying the *Heer* criteria to the facts of the case, the court had little difficulty in concluding that Taubenfeld "continued to contribute substantial services despite the reduced work hours."<sup>105</sup> With regard to the second point of the analysis, the court found no evidence that the duties performed by Taubenfeld's wife and two sons were not commensurate with their increased salaries.<sup>106</sup> Finally, without articulating any supporting rationale, the

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103. 685 F. Supp. at 239.

104. 685 F. Supp. at 240 n.4. The court cited *Bryan v. Mathews*, 427 F. Supp. 1263 (D.D.C. 1977) as its authority for this position. Under this approach, even if the evidence demonstrates that Taubenfeld's salary was not indicative of his worth to the business, this would not, standing alone, preclude receipt of benefits, notwithstanding the fact that the value of services performed exceeds the maximum allowed by law.

105. 685 F. Supp. at 240.

106. *Id.*

court found no evidence to suggest Taubenfeld was being supported by a family member's income.<sup>107</sup> Thus, finding only one of the three factors discussed in *Heer* to be present, the court concluded the Secretary was without the authority to vitiate the corporation's salary arrangements and to reallocate compensation between Taubenfeld and his family members.<sup>108</sup> In so holding, the court pointed out that even where reallocation of income is warranted under the above standard, it is the sham wage payment to a family member that is constructively reallocated,<sup>109</sup> noting that under no circumstances does the Secretary have the authority to reclassify undistributed corporate profits as earnings.<sup>110</sup>

The *Taubenfeld* court, therefore, holds the performance of services, the value of which exceeds the maximum allowed by law, does not ipso facto preclude entitlement to retirement benefits. The *Taubenfeld* court, like the *Martin* court, further holds the Secretary may only vitiate the salary arrangements of a business when the evidence establishes the existence of a scheme of shifting wages through which the benefit applicant derives support.

Finally, *Toner v. Schweiker*,<sup>111</sup> like *Gardner*, employs a two-factor analysis in determining the circumstances under which the superficialities of fictitious income arrangements may be penetrated. The court described this two-factor test as follows:

Nevertheless, it is equally clear that, where an applicant for retirement insurance benefits continues to render substantial services for his corporate employer even after the time of his alleged retirement and the corporation pays wages to a member of the applicant's family which do not reflect the reasonable value of services provided to the corporation by the family member, the Secretary may treat the salary arrangement as a "sham" or "scheme of shifting wages." In such circumstances, the Secretary may determine that the salary arrangement is fictitious and may allocate income earned by the applicant's family member to the applicant in order to determine the latter's entitlement to retirement insurance benefits.<sup>112</sup>

The facts revealed Toner reduced his salary from \$15,600 to \$3,600 in the year of his alleged retirement. At the same time, his wife, previously an unsalaried employee, began receiving an annual salary of \$16,000.<sup>113</sup> The record also

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107. *Id.* That Taubenfeld's wife, with whom he lived, was the recipient of a substantial salary during the period in question makes this finding a curious one. Combined with evidence that Taubenfeld's salary was arguably not enough to provide for his subsistence, this finding would certainly suggest that he was supported by his wife's income.

108. 685 F. Supp. at 241.

109. 685 F. Supp. at 240.

110. *Id.* (quoting *Notini v. Heckler*, 624 F. Supp. 552, 554 (D. Mass. 1986)).

111. 537 F. Supp. 846 (W.D.N.Y. 1982).

112. 537 F. Supp. at 854 (citations omitted).

113. 537 F. Supp. at 850.

established that subsequent to his alleged retirement, Toner continued to be the controlling force in the business<sup>114</sup> while his wife's duties, consisting mainly of auxiliary functions such as maintaining the corporate office, fixing meals for employees, answering the phone, and filling in for absent employees, remained unchanged. Given these facts, the district court agreed with the Secretary's determination that Toner had improperly shifted wages to his spouse.<sup>115</sup> The court also found substantial evidence that supported the Secretary's allocation of three-quarters of the wife's salary to Toner, and the court agreed such allocation extinguished benefit entitlement.<sup>116</sup> *Toner*, therefore, is yet another example of the Secretary's policy of closely examining any shifting of income between family members at or near the time the application for benefits is filed. In many instances, this factor, standing alone, is the "red flag" that triggers a more careful review of the merits of the claim by the adjudicative component.

As the above discussion demonstrates, the courts have consistently recognized the right of the Secretary to vitiate fictitious income arrangements, albeit under limited circumstances. The courts unanimously agree that in order to vitiate a fictitious income arrangement, the existence of "allocable income" must be established. "Allocable income," the jurisprudence indicates, includes wages shifted to a family member or other individual,<sup>117</sup> as well as earnings disguised as dividend income<sup>118</sup> or other unearned income.<sup>119</sup> To date, no district or appellate court decisions have found undistributed corporate earnings to be allocable income. In fact, the *Gardner*, *Ludeking*, and *Taubenfeld* courts expressly repudiated this proposition. Because the courts perceive the Secretary's authority to vitiate fictitious income arrangements as a right of reallocation of income, the Secretary may only adjust the benefit applicant's earnings to the extent of the amount of sham wage payments made or, where applicable, the amount of earned income disguised as dividends, rental receipts, or other unearned income. Thus, where allocable income cannot be identified, the Secretary simply does not have authority to vitiate fictitious income arrangements.

With regard to the courts' handling of wage shifting schemes, the *Gardner*, *Berger*, *Martin*, *Taubenfeld*, and *Toner* courts agree that a salary arrangement may not be vitiated unless the evidence establishes that the earnings claimed by the benefit applicant are not in keeping with his worth to the business, and a family member or other individual has received an increase in salary with no commensurate increase in duties. However, *Martin* and *Taubenfeld* stipulate that the evidence must *also* demonstrate that the benefit applicant derives support

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114. 537 F. Supp. at 855.

115. *Id.*

116. 537 F. Supp. at 855-56.

117. *Gardner v. Hall*, 366 F.2d 132, 135 (10th Cir. 1966).

118. *Ludeking v. Finch*, 421 F.2d 499, 503 (8th Cir. 1970).

119. *Roper v. Secretary of Health and Human Services*, 769 F. Supp. 243, 248 (N.D. Ohio 1990).

from the wage shifting scheme. *Berger*, *Gardner*, and *Toner* clearly do not impose such a requirement.

The application of differing standards by the courts in determining the circumstances under which the Secretary may vitiate unrepresentative salary arrangements can be attributed, in large part, to the absence of any statutory or regulatory guidance on such issue. The apparent irreconcilability of the *Berger* and *Martin* decisions is particularly troublesome when one considers that both decisions have been adopted as rulings by the Secretary. Thus, the Secretary is now on record as having endorsed what appear to be conflicting positions on this important issue. If the Secretary in fact, through the adoption of *Martin* as a ruling, intended to impose a more onerous standard on the exercise of the Secretary's authority to vitiate fictitious income arrangements, one cannot help but wonder why S.S.R. 88-12c was not rescinded in connection with the Secretary's adoption of the *Martin* decision as S.S.R. 91-1c. Could it be the Secretary has failed to recognize the irreconcilability of these decisions? A close review of *Martin*, which adopts the three-point analysis discussed by the Sixth Circuit in *Heer* as the applicable standard, reveals that the court did not even acknowledge that *Berger* had previously been adopted by the Secretary as a ruling, nor did the court in *Martin* even so much as make reference to the *Berger* decision! This, indeed, is a curious finding when one considers the fact that *Berger*, not *Heer*, was the most recent pronouncement of the Sixth Circuit on this issue at the time *Martin* was decided.

Thus, in the final analysis, the Secretary's adoption of *Martin* as a ruling, while unquestionably a commendable effort to clarify his position on a difficult issue, raises more questions than it answers. Ironically, the state of confusion currently existing in this area of the law is not the result of the Secretary's having adopted, through its promulgation of S.S.R. 91-1c, a position no longer the law of the Sixth Circuit. In fact, by adopting the Eleventh Circuit's decision in *Martin* as a ruling, the Secretary has endorsed a position that was *never* the law of the Sixth Circuit because, contrary to the court's finding in *Martin*, *Heer* clearly does not hold that all three factors discussed therein must be present in order for the Secretary to have the authority to vitiate wage shifting schemes.<sup>120</sup> To further confuse matters, the Secretary failed to rescind S.S.R. 88-12c contemporaneously with the adoption of S.S.R. 91-1c, thus leaving everyone wondering what the Secretary's current position is with regard to this crucial issue.

The Secretary must now act to clear up the confusion resulting from the adoption of differing standards as to the circumstances under which unrepresented salary arrangements may be vitiated. The Secretary can best end the confusion by filling the void currently existing in the present regulatory scheme through the adoption of new regulatory provisions delineating the circumstances under which such income-shifting arrangements may be vitiated by the Secretary.

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120. See *supra* text accompanying note 49.

Nothing short of regulatory action will suffice considering the divergence of present opinion largely attributable to the fact that the only guidance offered by the Secretary up to this point has come through the issuance of rulings not binding upon the courts<sup>121</sup> and seldom recognized as persuasive authority by the jurisprudence. Furthermore, in addition to regulating the circumstances under which wage shifting schemes may be vitiated, the Secretary should also define by regulation the circumstances under which other fictitious income arrangements may be vitiated, including those arrangements through which the benefit applicant converts or reclassifies earnings as dividends or other unearned income.

#### *D. What Should the Correct Standard Be?*

In an effort to ascertain the legally correct standard for determining the circumstances under which the Secretary may vitiate fictitious income arrangements, examination of the Act, regulations, and legislative history is now appropriate. As noted previously, the courts have consistently conditioned the exercise of the Secretary's authority to vitiate income arrangements on the existence of allocable income arising out of a wage shifting scheme or out of another arrangement through which income has been diverted, converted, or reclassified. While the courts do not agree on the precise standard to be applied when dealing with wage shifting schemes, the cases have consistently held allocable or shifted wages must always exist before the salary arrangements of a business may be vitiated.<sup>122</sup> In cases involving efforts to convert or reclassify earnings as unearned income are concerned, the courts have applied a uniform standard. Disguised earnings may not be reallocated to the benefit applicant for purposes of determining entitlement unless the evidence establishes the converted or reclassified earnings were actually received by the individual claiming benefits as dividend income, rental receipts, or some other form of unearned income.<sup>123</sup>

An alternative approach would allow the Secretary to vitiate *any* unrepresented income arrangement. Under this approach, in any case in which the earned income claimed by the benefit applicant is not representative of his worth to the business, the Secretary would have the right to pierce the superficialities of the arrangement and to assess benefit entitlement on the basis of the reasonable value of services performed. Here, the Secretary's authority to adjust the benefit applicant's earnings is not tied in any way to the existence or amount of allocable income, and benefit entitlement is accordingly judged on the basis of the reasonable value of services performed in any case in which an unrepresentative income arrangement is shown to exist. In spite of the lack of jurisprudential support for such a standard, the Secretary should adopt by

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121. See *supra* note 4.

122. See *infra* pp. 1066-67.

123. Gardner v. Hall, 366 F.2d 132 (10th Cir. 1966); Ludeking v. Finch, 421 F.2d 499 (8th Cir. 1970); Taubenfeld v. Bowen, 685 F. Supp. 237 (S.D. Fla. 1988).

regulation this value-oriented approach to resolving questionable retirement issues, thus repudiating the allocable income standards advanced by the courts. Two persuasive arguments are submitted in support of this position.

First, the basic purpose of both the retirement and disability insurance programs established by Congress is to replace earnings lost as a result of the worker's leaving the labor market because of old age or disability.<sup>124</sup> Without question, the court-adopted standards for vitiating income arrangements undermine, rather than further, this fundamental purpose. Consider the following scenarios. *Martin* and *Taubenfeld*, as discussed, hold the salary arrangements of a business cannot be vitiated unless the evidence demonstrates that the benefit applicant derives support from a family member to whom he has improperly shifted or diverted wages. Under this standard, the owner of a closely held corporation with earnings in excess of the maximum allowed by law may, upon reaching early retirement or retirement age, arbitrarily reduce his earnings below the applicable exempt amount, channel the difference to a son, daughter, or other individual, and draw full retirement benefits as long as he does not derive support through such arrangement. In fact, *Martin* sanctions full benefit recovery under such scenario even where the benefit applicant continues to work on a full time basis. But, can it reasonably be argued that the fundamental purpose of the retirement insurance program is furthered by awarding benefits under these circumstances? Have earnings been "lost" because of "old age" or "retirement"? I submit not.

Second, the slightly less onerous standard imposed in *Gardner, Berger, and Toner* would indeed allow the Secretary to vitiate the above fictitious salary arrangement and constructively reallocate the shifted or diverted wages to the wage earner for purposes of determining entitlement to benefits. Under an equally disturbing scenario, however, recovery of benefits can be had under this standard as well as under the court-adopted standard for vitiating arrangements through which earnings are converted or reclassified as unearned income. Assume the same factors noted above except here the business owner elects to funnel the savings derived from his self-imposed reduction in salary back into the corporation. Without question, the net worth of the business will be increased proportionate to any reduction in salary, and this, of course, inures to the benefit of the business owner. The business owner then is no less rewarded for his labor under these facts than if he had continued to accept full compensation for services rendered. Considering this result, is the business owner under these facts any more "retired" than in the first example? More to the point, should an individual be afforded the basic protection of the retirement insurance program when, in substance, he has simply funneled income back into his

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124. S. Rep. No. 1669, 81st Cong., 2d Sess. (1950). See also *Mathews v. De Castro*, 429 U.S. 181, 185-86, 97 S. Ct. 431, 434 (1976) (The primary objective of the Old Age Insurance Program established under Title II "was to provide workers and their families with basic protection against hardships created by lost earnings due to . . . old age.")

business while continuing to work on a full-time basis? That the wages are shifted or diverted back to the business and not to another individual should be of no moment. Yet, interestingly, under the court-adopted standards noted above, recovery of full benefits is allowed under these facts but denied under the first scenario. In each instance, income has only been diverted or shifted, not "lost" through "retirement." For this reason, recovery of benefits in either case undermines the beneficent purposes for which the retirement insurance program was established.

In summary, the above examples succinctly point out that the court-adopted standards for vitiating income arrangements are amenable to efforts to recover benefits through contrived or unrepresentative arrangements. This result can be attributed to court-adopted standards that place excessive and legally insupportable constraints on the Secretary's vitiating powers, thus precluding the exposure of many of the corporate shell games devised by overzealous benefit applicants. In practical effect, the court-adopted standards have unwittingly established gaping "loopholes" in the retirement insurance program and have therefore unquestionably undermined its basic purpose.

### III. THE VALUE-ORIENTED STANDARD

A closer look at the value-oriented standard endorsed by this article and the extent to which this approach furthers the fundamental purpose for which the retirement insurance program was established is appropriate. As noted previously, under this standard, the Secretary is vested with the authority to vitiate any income arrangement which is fictitious—any income arrangement in which the earned income claimed is not indicative of the value of services rendered by the benefit applicant. Once the income arrangement of the business is vitiated, benefit entitlement then turns on the value of services rendered by the benefit applicant, irrespective of the existence or amount of allocable income. This approach to resolving questionable retirement issues assuredly furthers the overriding purpose of the retirement insurance program because under a proper application of this standard, any and all arrangements whereby income may be shifted, diverted, converted, or reclassified are subject to the vitiating powers of the Secretary. Under this approach, benefits are only paid to those individuals whose earnings are reduced as a result of a cessation or reduction in work activity rather than as a result of a rechannelization or reclassification of earnings. Hence, this value-oriented approach to resolving questionable retirement issues would call for a denial of benefits in each of the factual scenarios discussed above. With regard to the first scenario, wherein the benefit applicant diverts a portion of his earnings to a family member or other individual in order to qualify for benefits, the Secretary would be free to vitiate the salary arrangement as the earned income claimed by the wage earner is clearly



unrepresentative of the value of services rendered.<sup>125</sup> Entitlement to benefits would therefore be judged on the basis of the reasonable value of services rendered which, in this case, exceeds the maximum allowed by law as evidenced by the benefit applicant's earnings being in excess of such amount prior to the implementation of this fictitious salary arrangement. Thus, recovery of benefits is denied as the fictitious salary arrangement contrived by the benefit applicant has been exposed and properly vitiated.

Recovery of benefits is likewise denied under the second factual scenario discussed above. In this scenario, the owner of a closely held corporation arbitrarily reduces his earnings below the applicable exempt amount, funnels the wage savings back into the business, and continues to work on a full time basis. Because the benefit applicant has not reduced his work activity, the value of the services he renders to the business continues to be in excess of the maximum allowed by law. Under the value-oriented standard, however, the fictitious income arrangement would be vitiated, as the claimed earnings do not reflect the individual's worth to the business. The Secretary would judge entitlement to benefits based on the reasonable value of services performed and would deny the application for benefits. In summary, the above observations and discussion make clear that the value-oriented approach to resolving questionable retirement issues furthers the beneficent purposes for which the retirement insurance program was established. Benefits are not awarded unless earnings are lost because of the cessation or substantial reduction of work activity otherwise known as "retirement." This standard, therefore, should be adopted in regulatory form by the Secretary.

A second, albeit less compelling reason for the establishment of the retirement insurance program, is to encourage retirement at age sixty-two or beyond to create job opportunities for younger workers.<sup>126</sup> The court-adopted standards for vitiating income arrangements do not undermine this purpose by discouraging, rather than encouraging, retirement by endorsing receipt of full benefits by individuals who continue to work on a full or near a full time basis provided the benefit applicant is astute enough to avoid those fictitious income arrangements proscribed by the jurisprudence. Conversely, the value-oriented standard promotes retirement at age sixty-two or beyond by reducing or eliminating the benefits of any individual who elects to continue working in any case in which the level of work activity, as revealed by the value assigned to the work activity, exceeds regulatory prescribed levels.

This author, therefore, advocates that the Secretary adopt by regulation the value-oriented standard. The ratification of this standard by regulation will achieve two very important ends. First, the Secretary will have finally moved

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125. This result can be logically deduced from the fact that the benefit applicant was paid significantly higher wages for the performance of the same services prior to his alleged "retirement."

126. H.R. Rep. No. 702, 95th Cong., 1st Sess., pt. 1, at 49 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4155, 4206.

to fill a significant void in the current regulatory scheme as presently no regulations defining the circumstances under which the Secretary may vitiate income arrangements exist. Second, the Secretary will have substantially reduced the likelihood of benefits being obtained through contrived or fictitious income arrangements. Further, contemporaneous with the adoption of the value-oriented standard by regulation, the Secretary should rescind both S.S.R. 91-1c and S.S.R. 88-12c. These rulings endorse irreconcilable court-adopted standards for vitiating fictitious income arrangements, and *both* standards undermine the purposes for which the retirement insurance program was established.

#### IV. ADJUSTMENT OR RECOVERY OF OVERPAID BENEFITS

Section 404(a)(1) provides that where the Secretary "finds that more or less than the correct amount of payment has been made to any person under this subchapter, proper adjustment or recovery shall be made, under regulations prescribed by the Secretary."<sup>127</sup> Section 404(b) stipulates that no adjustment or recovery will be allowed to any person who is without fault if adjustment or recovery "would defeat the purposes of this subchapter or would be against equity and good consequence."<sup>128</sup> The Secretary's implementing regulations are contained at Subpart F of Part 404 of the Code of Federal Regulations.<sup>129</sup> A brief review of these regulations follows.

The regulations provide that the term "overpayment" "includes a payment in excess of the amount due under Title II of the Act, a failure to impose deductions or to suspend or reduce benefits[,] . . . and a payment where no amount is payable under Title II of the Act."<sup>130</sup> The regulations divide overpayments into two broad categories—deduction overpayments and entitlement overpayments. While no definition is provided by regulation, a review of the types of deduction overpayments enumerated under Section 404.510 reveals that the term refers to overpayments resulting from the failure of the Secretary to implement deductions or offsets provided for in the Act or regulations.<sup>131</sup> For example, an overpayment resulting from the receipt of excess earnings by a recipient of retirement insurance benefits is considered a "deduction overpayment." The regulations define an "entitlement overpayment" as a benefit payment to an individual who does not satisfy the elements of entitlement provided by the Act or regulation or a benefit payment in excess of the amount to which such person is entitled.<sup>132</sup> The erroneous payment of retirement benefits to an individual who is under the age of sixty-two would be

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127. 42 U.S.C. § 404(a)(1) (1988).

128. 42 U.S.C. § 404(b) (1988).

129. 20 C.F.R. § 404 (1988) [hereinafter referred to by section number].

130. 20 C.F.R. § 404.501(a) (1994).

131. 20 C.F.R. § 404.510 (1994).

132. 20 C.F.R. § 404.510a (1994).

in the nature of an entitlement overpayment, as would an overpayment resulting from the erroneous calculation of the monthly benefit amount.

Section 404.506 reaffirms the benefit recipient's entitlement to waiver of adjustment or recovery of the overpayment where such person is: (1) without fault, and (2) adjustment or recovery would either defeat the purposes of the Act or be against equity and good conscience.<sup>133</sup> Section 404.507 provides that the following acts or omissions are deemed to constitute fault under the regulations:

- (a) a statement made by an individual who knew or should have known such statement was false or inaccurate;
- (b) failure to furnish information when the individual knew or should have known that such information was material to the claim;
- (c) acceptance of benefits the individual knew or should have known were not owed.<sup>134</sup>

Section 404.507 further provides that in determining whether or not the benefit applicant is at fault, all pertinent circumstances, including age, education, mental and physical capacity, are to be taken into consideration.<sup>135</sup> The recipients of deduction overpayments are, however, held to a higher standard of care under the regulations. Specifically, Section 404.511(a) states that in the case of a deduction overpayment, fault is established if the individual either lacks "good faith" or fails to exercise a high degree of care "in determining whether circumstances which may cause deductions from his benefits should be brought to the attention of the Administration."<sup>136</sup>

Section 404.508(a) provides that adjustment or recovery is deemed to defeat the purposes of the Act when it operates to deprive the individual of income required for ordinary and necessary living expenses.<sup>137</sup> Section 404.509 states that adjustment or recovery of an overpayment is deemed against equity and good conscience in either of the following situations:

- (a) the individual from whom adjustment or recovery is sought has changed his position for the worse or relinquished a valuable right in reliance upon funds received or in reliance upon a notice of forthcoming payments;

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133. 20 C.F.R. § 404.506 (1994). In keeping with longstanding policy, S.S.R. 94-4p (Cum. Ed. 1990-91) recognizes the benefit recipient's right to a pre-recoupment hearing before a request for waiver can be denied. S.S.R. 94-4p further provides that at the pre-recoupment hearing, the benefit recipient has the right to testify, cross examine witnesses, offer documents into evidence, and make arguments—with or without the assistance of a legal representative. The ruling clearly provides, however, that if the individual from whom the adjustment or recovery is sought contests the correctness of the overpayment but does not claim entitlement to a waiver, the individual has no right to a pre-recoupment hearing.

134. 20 C.F.R. § 404.507 (1994).

135. 20 C.F.R. § 404.507 (1994).

136. 20 C.F.R. § 404.511(a) (1994).

137. 20 C.F.R. § 404.508(a) (1994).

(b) the individual from whom adjustment or recovery is sought was living in a separate household from the overpaid individual at the time such payment was made and did not receive any portion thereof.<sup>138</sup>

Section 507 provides that the fault of the Secretary in causing the overpayment does not bar adjustment or recovery thereof.<sup>139</sup> However, one exception to this rule exists. Section 404.510 states that as to the types of deduction overpayments enumerated therein,<sup>140</sup> the benefit recipient shall be deemed without fault if any of the circumstances described in the succeeding subsections of the regulation are shown to exist.<sup>141</sup> One such circumstance, described under subsection (b), is an overpayment resulting from the individual's reliance upon an erroneous interpretation of the Act or regulations by a source within the Social Security Administration or other governmental agency that the benefit recipient reasonably believed was connected with the administration of benefits. Hence, if a recipient of retirement insurance benefits, relying upon an erroneous interpretation of a statutory or regulatory provision by a claims representative employed by the Social Security Administration, fails to report excess earnings, the recipient is deemed without fault in causing the overpayment. Additionally, Section 405.510(a) provides that, as to *any* entitlement overpayment, the benefit recipient is deemed without fault in any case in which the circumstances described at Section 404.510(b) are shown to exist.<sup>142</sup> Furthermore, Section 404.512 states that "in the situations described in §§ 404.510(b) . . . and 404.510(a), adjustment or recovery will be waived since it will be deemed such adjustment or recovery is against equity and good conscience."<sup>143</sup> Thus, if a deduction overpayment arises from excess earnings received by a recipient of

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138. 20 C.F.R. § 404.509 (1994). 20 C.F.R. §§ 404.330-349 (1994) allow the spouse of an insured individual entitled to retirement or disability benefits to draw spousal benefits under limited circumstances. The circumstances described above could therefore arise, for example, if either the insured individual or his/her spouse is overpaid benefits while such parties are living separate and apart from each other.

139. 20 C.F.R. § 404.507 (1994).

140. One of the overpayments listed under 20 C.F.R. § 404.510 (1994) is an overpayment resulting from the failure to report an event described under 42 U.S.C. § 403(b) (1988 & Supp. V 1993) dealing in part with deductions from retirement benefits based on work activity. The remaining deduction overpayments described at 20 C.F.R. § 404.510 (1994) have somewhat limited application. *See, e.g.*, 42 U.S.C. § 403(c) (1988) (deductions from old age and survivor's benefits because of non-covered work outside the United States or because of failure to have child in one's care); 42 U.S.C. § 403(d) (1988 & Supp. V 1993) (deductions from dependents' benefits on account of non-covered work outside the United States by old age insurance beneficiary); 42 U.S.C. § 422(b) (1988) (deductions from disability insurance benefits because of refusal to accept rehabilitation services); 42 U.S.C. § 402(t) (1988 & Supp. V 1993) (suspension of old age and survivor's insurance benefits of aliens living outside the United States; residency requirements for dependents and survivors); 42 U.S.C. § 428 (1988) (benefits at age seventy-two for certain uninsured individuals).

141. 20 C.F.R. § 404.510 (1994).

142. 20 C.F.R. § 404.510(a) (1994).

143. 20 C.F.R. § 404.512 (1994).

retirement benefits or if any entitlement overpayment is involved, the benefit recipient is entitled to waiver in any case in which the evidence establishes that the overpaid benefits were received in reliance upon an erroneous interpretation of the Act or regulations by any of the parties described above.

Once the liability of the overpaid individual is fixed, the Secretary may enforce collection through a variety of methods. Section 404.502(a) provides that if the overpaid individual is alive and receiving disability, retirement, or other benefits provided under Title II of the Act, the Secretary is authorized to withhold the full amount of Title II benefits payable to such person until a sum equal to the amount of the overpayment has been recovered.<sup>144</sup> Section 404.502(b) provides that if the overpaid individual is deceased, the Secretary may seek recovery directly from the estate of the overpaid individual or withhold any Title II benefits payable to such estate.<sup>145</sup> S.S.R. 87-8<sup>146</sup> provides that the heir of an overpaid individual is liable for the overpayment to the extent of the value of such individual's inheritance. This ruling further provides that where the heir has taken possession of his share of the estate, the liability of such person is limited to the amount of "estate assets in his possession at the time of receipt of the overpaid notice."<sup>147</sup> Finally, if the overpaid individual is not currently receiving Title II benefits, Section 404.515 authorizes the Secretary to refer the claim to the Internal Revenue Service for offset against any tax refunds payable to such person.<sup>148</sup>

The jurisprudence has played an active role in recent years both in establishing and interpreting overpayment law. Curiously, the Act and regulations do not assign the burden of proof where adjustment (offsetting) or recovery of overpaid benefits or entitlement to waiver is at issue.<sup>149</sup> Hence, the jurisprudence must answer these important questions. *Cannuni on Behalf of Cannuni v. Schweiker*<sup>150</sup> holds that in overpayment proceedings, the Secretary must establish the fact of the overpayment. Conversely, *Valente v. Secretary of Health and Human Services*<sup>151</sup> holds that the benefit recipient has the burden of proving entitlement to a waiver of adjustment or recovery. *Cannuni* and *Valente* would seem to be consistent with fundamental common-law precepts as

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144. 20 C.F.R. 404.502(a) (1994).

145. 20 C.F.R. § 404.502(b) (1994).

146. S.S.R. 87-8 (Cum. Ed. 1987).

147. While the Secretary has not spoken to this issue, one can reasonably assume that the heir's liability would not be so limited if the evidence establishes that the heir disposed of estate property with knowledge of the existence of the overpayment.

148. 20 C.F.R. § 404.515 (1994).

149. 20 C.F.R. § 404.704 (1994) assigns the burden of proof in cases in which entitlement or continued entitlement to benefits is at issue. This regulation therefore does not apply to cases in which the Secretary seeks adjustment or recovery of overpaid benefits or in which entitlement to waiver is claimed by the benefit recipient.

150. 740 F.2d 260 (3d Cir. 1984). See also *United States v. Smith*, 482 F.2d 1120 (8th Cir. 1973).

151. 733 F.2d 1037 (2d Cir. 1984).

in each case the burden of proof is placed on the party seeking relief, be it the Secretary or the benefit recipient.

Two rather interesting cases dealing with the fault issue are worthy of discussion herein. In *Austin v. Shalala*,<sup>152</sup> Austin's husband died in 1968, and she was awarded widow's insurance benefits based on his earnings record pursuant to an application filed in September of 1980.<sup>153</sup> She thereafter filed a claim for retirement insurance benefits based on her own earnings record in June of 1987. In processing the latter application, it was discovered that Austin had married again in 1977 which ipso facto disqualified her from receiving widow's benefits.<sup>154</sup> Accordingly, the Secretary assessed an overpayment of \$24,705. Austin requested waiver of the overpayment, claiming that at the time the application for widow's benefits was filed, she advised the claims officer she was in the process of obtaining a divorce but had not yet instituted legal proceedings. Austin further stated that at no time did the claims officer advise her that the existing marriage disqualified her from receiving widow's benefits.<sup>155</sup> The application for widow's benefits, completed by the claims officer based on information supplied by Austin, did not contain any information regarding Austin's existing marriage. The evidence further revealed that Austin in fact never did file for divorce as she reconciled with her husband five months after filing the application for widow's benefits.

The Fifth Circuit concluded substantial evidence supported the administrative law judge's determination that Austin was negligent in signing the application form without reviewing and verifying its contents.<sup>156</sup> As to whether or not Austin's negligence constituted "fault" under 20 C.F.R. §§ 404.506 and 404.507, the court answered this question in the affirmative, noting that "when a claimant fails to read a benefit form and verify that the information therein is correct, the claimant who signs the form may be held to be 'at fault' if the information turns out to be incorrect."<sup>157</sup> This being the case, the court held that the administrative law judge properly denied Austin's request for waiver, notwithstanding the fact that the claims officer may have erred in failing to report information which would have disqualified Austin from receiving benefits.<sup>158</sup>

Perhaps the claimant's request for waiver should have been granted under Section 404.512(a) of the regulations. The overpayment in question was clearly an entitlement overpayment as it arose because the benefit applicant failed to

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152. 994 F.2d 1170 (5th Cir. 1993).

153. See *supra* note 138.

154. See 20 C.F.R. § 404.336(e) (1994), which provides that, subject to the three exceptions enumerated therein, remarriage extinguishes entitlement to widow's benefits.

155. Austin's testimony in this regard is taken from the district court's opinion affirming the Secretary's denial of Austin's waiver request. *Austin v. Sullivan*, 830 F. Supp. 329 (N.D. Tex. 1992).

156. 994 F.2d at 1174.

157. *Id.*

158. *Id.* Recall that 20 C.F.R. § 404.507 (1994) provides that the fault of the Secretary will generally not bar adjustment or recovery of overpaid benefits.

meet one of the conditions of entitlement under Section 404.335, i.e., that she be unmarried. Assuming the testimony to be accurate, one could argue that by failing to advise Austin that her undissolved marriage precluded receipt of benefits, the claims officer tacitly and erroneously represented that it had no effect on benefit entitlement. If one accepts this premise, recovery of overpaid benefits is deemed against equity and good conscience and is therefore waived under Section 404.512(a).<sup>159</sup> The judiciary will not likely ever accept such a broad interpretation of Section 512(a), even in those circuits recognized for their heightened sensitivity to the rights of benefit claimants. In fact, this argument was implicitly rejected by the Fifth Circuit as the court held the claims officer had not supplied erroneous information to Austin when she filed her application for widow's benefits. Unfortunately, however, the Fifth Circuit did not specifically address the tacit misrepresentation issue as Austin failed to advance this argument on appeal.

In *Lang v. Sullivan*,<sup>160</sup> the Secretary determined Lang had been overpaid benefits totalling \$19,685.35 in 1986 and \$6,760.70 in 1987. Lang worked as a self-employed acquisitions broker, earning fees and commissions at unpredictable times and in varying amounts. Lang testified that he might work two calendar years on a project, incurring operating losses along the way, and that he might receive payment for such work a year or two after the work was completed. Lang maintained that he was not at fault in causing the overpayments in question because he reasonably assumed that Internal Revenue Code regulations permitting taxpayers to allocate net operating losses to subsequent years also applied in computing earnings for purposes of determining entitlement to retirement benefits. He contended that, having reasonably relied upon information provided by a governmental agency, the Internal Revenue Service, he could not be held accountable for the overpayment. Lang also asserted that he was misled by a brochure published by the Social Security Administration discussing "allowable" business deductions for purposes of determining entitlement to retirement benefits. The court, however, rejected both arguments and affirmed the Secretary's determination that Lang was at fault in causing the overpayments. The court stated:

A review of the record indicates that plaintiff was not without fault in his receipt of the overpayments. Giving this plaintiff the most generous interpretation of his intentions to pursue what he believed was a permissible deduction does not relieve him of fault in the overpayment. The record's findings are self evident that there were sufficient opportunities for the plaintiff to acquire accurate and thorough information to guide him in his financial affairs. The court is particularly persuaded in this regard by the plaintiff's refusal to provide timely

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159. See *infra* p. 1076 and *supra* note 140.

160. 762 F. Supp. 628 (D.N.J.), *aff'd mem.*, 947 F.2d 628 (3d Cir. 1991), *cert. denied*, 115 S. Ct. 157 (1994).

reports of net earnings to the Social Security Administration as required by 20 C.F.R. § 404.452. Compliance with earnings reporting requirements would have served to identify the potential for overpayment such that remedial action could have been attended by both plaintiff and the Administration.

. . . Plaintiff listed on his federal income tax statements for 1986 and 1987 that he was self-employed as a merger and acquisition consultant. On his brief filed pursuant to this appeal, he indicated that he received earnings from unexpected mergers and acquisitions. The type of financial activity that plaintiff is successfully engaged in is sufficiently sophisticated in regard to finance. A reasonable view, and thus, the view of this court, is that an individual capable of professional involvement in such transactions is expected to have sufficient, if not advanced, understanding of his own financial matters. Plaintiff, however pleads to this court that waiver is entitled [sic] since he relied in part upon a handout brochure disseminated by the Administration. The court remains unpersuaded and is of the opinion that a merger and acquisitions broker would not rely on a descriptive brochure as a substantive resource and authority for an acquisitions project. The suspect brochure specifies "allowable" business deductions which the court reads as sufficient notice to Social Security income recipients, particularly those with experience in complex financial matters, to exercise care in their income reporting.<sup>161</sup>

Two recent decisions have repudiated the Secretary's interpretation of the phrase "against equity and good conscience" provided in Section 404.509.<sup>162</sup> In *Groseclose v. Bowen*,<sup>163</sup> the Secretary sought to recover child's benefits<sup>164</sup> erroneously paid to Groseclose's daughter through deductions from his monthly retirement insurance benefits. Groseclose requested waiver of recovery, claiming that it would be against equity and good conscience to compel him to make restitution. His request was denied through the Appeals Council level, and the Secretary's determination was thereafter affirmed by the district court. On review, the Eighth Circuit noted that the evidence clearly established that Groseclose was not at fault in causing the overpayment, that he had not received any portion of the funds involved, and that he was not aware that his daughter, who was not living with him at the time, had received benefits during the period in question.<sup>165</sup> In reviewing the applicable law, the court noted that while Section 404(b) was silent as to the meaning of the phrase "against equity and

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161. 762 F. Supp. at 631-32.

162. 20 C.F.R. § 404.509 (1994).

163. 809 F.2d 502 (8th Cir. 1987).

164. 20 C.F.R. § 404.350-69 (1994) enumerate the circumstances under which entitlement to child's benefits is established.

165. 809 F.2d at 504-05.



good conscience," the Secretary had declared by regulation that adjustment or recovery of overpaid benefits shall not be deemed against equity and good conscience unless the benefit recipient had relinquished a valuable right or changed his position for the worse in reliance upon the overpaid benefits or in reliance upon a notice of payment of benefits.<sup>166</sup> The Eighth Circuit agreed with the district court that under the Secretary's narrow interpretation of this phrase, Groseclose was clearly not entitled to waiver as the record failed to establish the existence of either of the circumstances enumerated in Section 404.509.<sup>167</sup> Thus, the court turned its attention to Groseclose's claim that the Secretary's interpretation of the phrase "against equity and good conscience" was invalid. In evaluating this argument, the court recognized that "an agency's interpretation of the statute that it is charged with administering is entitled to considerable deference," noting that the court may not substitute its own construction if the Secretary's interpretation is reasonable.<sup>168</sup> The Eighth Circuit pointed out, however, quoting *Southeastern Community College v. Davis*,<sup>169</sup> that such deference is constrained by the court's obligation to adhere to the unambiguous meaning of a statute as determined through careful consideration of its language, purpose, and legislative history.<sup>170</sup> Applying the rule of statutory construction adopted by the Supreme Court in *Perrin v. United States*,<sup>171</sup> the court noted that if, as here, the statute is silent as to the meaning of a phrase, the words are to be interpreted according to their common, ordinary meaning.<sup>172</sup> The court then looked to a California Supreme Court decision, *Gilles v. Department of Human Resources Development*,<sup>173</sup> for guidance in interpreting the language of the statute. In *Gilles*, the court found "against equity and good conscience" to be a phrase of uncommon generality, not at all amenable to efforts to channel its meaning into rigid or specific rules.<sup>174</sup> Adopting the court's interpretation in *Gilles*, the Eighth Circuit concluded the adjudicator must be allowed to draw upon fundamental precepts of justice and morality in applying the phrase "against equity and good conscience."<sup>175</sup> Because the Secretary's interpretation contained at Section 404.509 clearly failed to provide such latitude, it did not reflect the common, ordinary meaning of this

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166. 809 F.2d at 504. At the time this case was decided, 20 C.F.R. § 404.509 (1994) provided that recovery of overpaid benefits would only be against equity and good conscience if the benefit recipient has "relinquished a valuable right . . . or changed his or her position for the worse" in reliance upon the overpaid benefits or in reliance upon a notice of payment of such benefits.

167. 809 F.2d at 504 n.1.

168. 809 F.2d at 505.

169. 442 U.S. 397, 411, 99 S. Ct. 2361, 2369 (1979).

170. 809 F.2d at 505.

171. 444 U.S. 37, 100 S. Ct. 311 (1979).

172. 809 F.2d at 505.

173. 521 P.2d 110 (Cal. 1974) (in bank).

174. 809 F.2d at 505.

175. *Id.* (quoting *Giles v. Department of Human Resources Development*, 521 P.2d 110 (Cal. 1974)).

phrase.<sup>176</sup> Next, the court examined the legislative history of Section 404(b) and noted that while the phrase “against equity and good conscience” was not expressly defined therein, it did reveal an intent to apply such language in keeping with a broad concept of fairness.<sup>177</sup> Considering this, the court concluded:

[I]t cannot be said that the relinquishment of a valuable right and the changing of one’s position for the worse represent the only circumstances in which recoupment would be inequitable. We find it difficult to imagine a more unfair or unjust situation than requiring a person who is without fault to repay overpaid benefits when that person had no knowledge of the overpayments. . . . Moreover, recoupment in this case would be inconsistent with the policy expressed in the legislative history—that recoupment should be equitable.<sup>178</sup>

Accordingly, the judgment of the district court affirming the Secretary’s denial of Groseclose’s request for a waiver was reversed,<sup>179</sup> and the Secretary was directed by the court to reimburse Groseclose for any benefits withheld from his monthly retirement checks during the pendency of this proceeding.<sup>180</sup>

The Secretary responded curiously to *Groseclose*. Given the Eighth Circuit’s comprehensive and well reasoned analysis of the language and legislative history of Section 404(b), one might have expected the Secretary to accede to the holding of *Groseclose* by amending Section 404.509 to incorporate the broad concept of fairness espoused by the court. Alternatively, one would expect the Secretary to adopt the Eighth Circuit’s decision via acquiescence ruling, thereby affirming that *Groseclose* is the law of the Eighth Circuit. The Secretary, however, rejected both of these approaches and opted instead to limit *Groseclose* to its facts. Accordingly, Section 404.509 was simply amended to provide that, in addition to the circumstances already specified therein, recovery of overpaid benefits from an individual who “was living in a separate household from the overpaid person at the time of the overpayment and did not receive the overpayment” is also against equity and good conscience.

In *Quinlivan v. Sullivan*,<sup>181</sup> the benefit recipient was incarcerated from 1963 to 1985 for a felony conviction. During his imprisonment, he began receiving Title II disability benefits as he suffered from a mental impairment which precluded the performance of work activity. In 1980, Congress amended the Act<sup>182</sup> to prohibit incarcerated felons from receiving disability benefits. Nevertheless, Quinlivan, who was unaware of any change in the law, continued

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176. *Id.*

177. 809 F.2d at 505-06.

178. 809 F.2d at 506.

179. *Id.*

180. *Id.*

181. 916 F.2d 524 (9th Cir. 1990).

182. 42 U.S.C. § 402(x)(1) (1988).

to receive benefits until 1982. At that time he advised the Social Security Administration of the overpayment after reading a booklet containing recent changes in Social Security law. Acting on this information, the Secretary immediately terminated benefits and forwarded to Quinlivan a notice demanding repayment of \$4,601.46 in overpaid benefits. Additionally, prior to Quinlivan's release from prison, the Secretary instituted a continuing disability review which resulted in a determination in 1983 that he was no longer disabled under the Act and regulations. Consequently, upon his release from prison in 1985, Quinlivan's disability benefits did not resume. However, pursuant to a subsequent application for benefits filed by Quinlivan, an administrative law judge determined in 1989 that a combination of physical and mental impairment rendered him unable to engage in work activity, and he was therefore once again entitled to benefits.<sup>183</sup>

The issue before the Ninth Circuit was Quinlivan's entitlement to a waiver of adjustment or recovery of overpaid benefits. Relying on the Eighth Circuit's decision in *Groseclose*, the court held it was not bound by the Secretary's interpretation of the phrase "against equity and good conscience" contained in Section 404.509(a) as the interpretation was inconsistent with the language and history of Section 404(b).<sup>184</sup> In so holding, the court observed that "Congress intended a broad concept of fairness to apply to waiver requests, one that reflects the ordinary meaning of the statutory language and takes into account the facts and circumstances of each case."<sup>185</sup> The court thus concluded Quinlivan was entitled to waiver as he was without fault in causing the overpayment, and recovery of the overpayment, given the facts, "would be against equity and good conscience as that phrase is commonly understood."<sup>186</sup> In support of its determination with regard to the latter issue, the court stated the following:

Upon release from prison, Quinlivan had no material goods, no means of transportation, and no income. During the three years before the hearing on his waiver claim, he worked sporadically, holding only a few temporary jobs. The ALJ who determined that Quinlivan was disabled in 1989 found that his psychological impairments prevented him from performing work during the preceding 12 months. It appears likely his ability to work in 1985-87 was similarly affected.<sup>187</sup>

The irony of *Quinlivan* is that the court unnecessarily reached the issue of whether it was bound by the Secretary's regulatory interpretation of the phrase "against equity and good conscience." The court noted in its review of the facts that Quinlivan's expenses exceeded his income which consisted of only \$314 a

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183. 916 F.2d at 526.

184. 916 F.2d at 526-27.

185. 916 F.2d at 527.

186. 916 F.2d at 526-27.

187. 916 F.2d at 527.

month in state welfare benefits.<sup>188</sup> The court therefore could have easily decided the case under Section 404.508.<sup>189</sup> This regulation provides that adjustment or recovery defeats the purposes of the Act when it operates "to deprive a person of income required for ordinary and necessary living expenses." Because Quinlivan did not have sufficient income to meet his basic living expenses even before considering the impact of adjustment or recovery, his circumstances clearly met the requirements of this regulation. Apparently, in its haste to decide the case under the rationale of *Groseclose*, the court simply overlooked Section 404.508.

In response to *Quinlivan*, the Secretary adopted ruling A.R. 92-5(9).<sup>190</sup> A.R. 92-5(9) sets forth the Secretary's interpretation of the *Quinlivan* decision and how it will be applied in the Ninth Circuit:

In determining whether recovery of an overpayment would be "against equity and good conscience," the adjudicator will not limit his or her inquiry to the three specific circumstances set forth in the regulations. The decision must take into account all of the facts and circumstances of the case and be based on a broad concept of fairness. Factors such as, but not limited to, the nature of the claimant's impairment, the amount and steadiness of the claimant's income, and the claimant's assets and material resources should all be considered in the decision as to whether recovery of an overpayment should be waived on the basis that recovery would be "against equity and good conscience."<sup>191</sup>

Arguably, under the broad criteria established in *Groseclose* and *Quinlivan*, the fault of the Secretary may, without more, render adjustment or recovery of overpaid benefits against equity and good conscience in some circumstances. This result may be reached, for example, if the fault of the Secretary is so egregious in nature that the equities of the case overwhelmingly favor the benefit recipient. One can expect this issue to reach the courts in the very near future.

In *Brown v. Bowen*,<sup>192</sup> Brown argued that the Secretary's claim for recovery of overpaid benefits was barred by administrative finality, statute of limitations, and laches. Brown's contention that the claim was barred by administrative finality was based on Section 404.988(b).<sup>193</sup> Brown maintained

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188. 916 F.2d at 525.

189. S.S.R. 92-5(9) (Cum. Ed. 1992).

190. *Id.* 20 C.F.R. § 404.508 (1994) was last amended in 1969. The 1990 version of this regulation is therefore identical to the current version.

191. S.S.R. 92-5(9) (Cum. Ed. 1992).

192. 660 F. Supp. 582 (N.D. Cal. 1987).

193. 20 C.F.R. § 404.988(b) (1994) provides that for good cause, a decision may be reopened within four years after an initial determination is rendered. The 1986 version of this regulation contained identical language. 20 C.F.R. § 404.989(a) (1994) states that there exists "good cause" to reopen a prior determination in any of the following circumstances: (a) new and material evidence is discovered, (b) clerical error in the computation or re-computation of benefits is found, (c)

that each benefit check issued to her was an "initial determination" by the Secretary that she continued to be entitled to benefits. Since the Secretary initiated the action for recovery more than four years after the dates of such disbursements, Brown asserted that the Secretary could not reopen these "initial determinations" and that Section 404.988(b) barred the Secretary's claim. However, the court was unpersuaded by this novel argument, pointing out that an initial determination is defined by regulation<sup>194</sup> as a determination by the Secretary that is subject to administrative and judicial review.<sup>195</sup> The court found that the determination of overpayment, not the processing and issuance of the benefit checks, was the "initial determination" subject to administrative or judicial review under the regulations.<sup>196</sup>

The court likewise rejected Brown's second contention that the six year statute of limitations provided by Section 2415(b)<sup>197</sup> barred recovery and in so doing, distinguished *United States v. Dimeo*<sup>198</sup> on two grounds. First, the court noted that unlike *Dimeo*, six years had not elapsed between the time the Secretary became aware of the facts giving rise to the claim and the institution of the action to recover benefits.<sup>199</sup> Second, the court observed that since *Dimeo* involved the misapplication of funds by a representative payee, the district court in that case correctly concluded that the case was controlled by Section 2415(b) as the claim was based upon a "diversion of monies paid under a grant program."<sup>200</sup> Unlike *Dimeo*, however, the court pointed out that in the case *sub judice*, improper diversion of funds was not the underlying basis of the claim as the government simply contended that benefits were erroneously paid to Brown.<sup>201</sup> The court noted in this regard that Section 2415(c) specifically states that "[n]othing herein shall be deemed to limit the time for bringing an action to establish the title to, or right of possession of, real or personal property."<sup>202</sup> An action to recover overpaid benefits, the court reasoned, is an

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evidence of record clearly indicates "on its face" that the decision is erroneous.

194. 20 C.F.R. § 404.902 (1986).

195. 660 F. Supp. at 586.

196. *Id.*

197. Subject to the provisions of Section 2416 of this title, and except as otherwise provided by Congress, every action for money damages brought by the United States or an officer or agency thereof which is founded upon a tort shall be barred unless the complaint is filed within three years after the right of action first accrues. *Provided*, that an action to recover . . . for diversion of money paid under a grant program . . . may be brought within six years after the right of action accrues. . . .

28 U.S.C. § 2415(b) (1988).

198. 371 F. Supp. 95 (N.D. Ga. 1974).

199. 660 F. Supp. at 586. Although not cited by the court, 28 U.S.C. § 2416(c) (1988) does provide that the limitations periods established by 28 U.S.C. § 2415 (1988) shall not commence until the facts giving rise to the claim are known or could reasonably have been ascertained by the United States government.

200. 660 F. Supp. at 586.

201. *Id.*

202. *Id.*

action to establish title to and/or possession of personal property.<sup>203</sup> Hence, the six year statute of limitations provided by Section 2415(b) did not apply.<sup>204</sup>

The court then summarily rejected Brown's final contention that the equitable doctrine of laches barred the claim. Because Brown had acknowledged fault in causing the overpayment, laches could not apply.<sup>205</sup> Thus, finding no legal basis upon which to bar recovery, the court affirmed the Secretary's determination that Brown was liable for the full amount of the overpayment.<sup>206</sup>

In *Gerstein v. Bowen*,<sup>207</sup> the Secretary initiated payment of retirement benefits despite denying Gerstein's application for benefits initially in April of 1982 and on reconsideration in November of 1982. Upon discovering this error in March of 1984, the Secretary terminated benefits and demanded repayment of overpaid benefits totalling \$19,116.80. Gerstein sought review and in June of 1985, an administrative law judge determined that Gerstein had in fact been retired since January of 1981 thereby extinguishing the Secretary's claim of overpayment. After the sixty-day period for requesting review had elapsed, the Secretary through the Appeals Council reopened the administrative law judge's decision awarding Gerstein retirement benefits and remanded the case for readjudication. Following remand, a second administrative law judge resurrected the Secretary's claim of overpayment by finding on October 15, 1986, that Gerstein had not established entitlement to retirement insurance benefits during the period at issue.<sup>208</sup> Gerstein urged in his appeal of the administrative law judge's decision that the regulatory provisions governing reopening were only applicable to claimants. Hence, the Secretary did not have the authority to reopen the first administrative law judge decision.<sup>209</sup>

While acknowledging its frustration "at trying to interpret a set of regulations that lend themselves to no rational reading,"<sup>210</sup> the district court ultimately concluded the regulations envision both the claimant and the Secretary exercising the right to reopen prior determinations.<sup>211</sup> The court then considered the constitutional challenge to the Secretary's authority to reopen prior determinations because it offends traditional notions of due process to allow the Secretary to reopen a prior favorable determination years after it is rendered in order to "disgorge" previously paid benefits.<sup>212</sup> The due process argument against allowing the Secretary to *sua sponte* reopen prior determinations, the court noted,

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203. *Id.*

204. *Id.*

205. 660 F. Supp. at 586-87.

206. 660 F. Supp. at 587.

207. 680 F. Supp. 1200 (N.D. Ill. 1988).

208. 680 F. Supp. at 1202.

209. 680 F. Supp. at 1204. 20 C.F.R. § 404.987 (1994) now specifically vests the Secretary with the authority to reopen prior determinations. 59 Fed. Reg. 8,535 (1994). At the time of this case, the statute did not vest the Secretary with this authority.

210. 680 F. Supp. at 1207.

211. *Id.*

212. 680 F. Supp. at 1208.

is therefore premised on the assumption that it places the benefit recipient in limbo for at least four years,<sup>213</sup> uncertain as to whether or not he should use benefits received to meet the "necessities of life" or place the funds in escrow so as to preserve his ability to make restitution in the unfortunate event the Secretary decides to reopen the claim.<sup>214</sup> One might argue, the court observed, that ownership of benefits under such circumstances is little more than an illusion or, at best, provisional in nature.<sup>215</sup> The court pointed out, however, that the benefit recipient's interest in decisional finality must be balanced against the interest of the Secretary in revising erroneous determinations to avoid continuing benefit payments to individuals clearly not entitled to such relief.<sup>216</sup> In the end, the court resolved the issue in favor of the Secretary, finding that the waiver provisions contained at Subpart F of the Code of Federal Regulations adequately addressed the constitutional concerns. These regulations allow "worthy persons" to avoid having to reimburse the Secretary for erroneous payments.

The regulations define the terms "fault," "defeat the purposes of this subchapter," and "against equity and good conscience." This safety valve measure, when employed judiciously, adequately safeguards a claimant's interest in finality. If a claimant has acted without fault and requiring repayment would place the claimant in dire financial straits, then the claimant will not be required to refund the overpayments. A claimant who acts properly and needs the social security benefits for necessary expenses does not have to "put the money in escrow for at least four years." A claimant simply must avail him or herself of the waiver procedures. The existence of those procedures satisfies due process.<sup>217</sup>

In upholding the constitutionality of the Secretary's regulatory authority to reopen prior determinations, the court refused to follow the First Circuit's decision in *McCuin v. Secretary of Health and Human Services*.<sup>218</sup> In *McCuin*, the issue was the Secretary's right to *sua sponte* reopen previous determinations of Medicare eligibility. In finding against the Secretary, the First Circuit noted that finality of determinations, as embodied in such doctrines as collateral estoppel and *res judicata*, is a basic tenet of our common-law system of adjudication, applicable as well to "administrative proceedings when an agency is acting in a judicial capacity."<sup>219</sup> The reopening power claimed by the

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213. *Id.* Recall that benefit determinations under Title II of the Act are generally subject to reopening for a period of four years. See *supra* note 193.

214. 680 F. Supp. at 1208-09.

215. 680 F. Supp. at 1208.

216. 680 F. Supp. at 1209.

217. 680 F. Supp. at 1209 (citations omitted).

218. 817 F.2d 161 (1st Cir. 1987).

219. 817 F.2d at 172.

Secretary under 20 C.F.R. Sections 404.987-89,<sup>220</sup> the court observed, "takes away the finality that adjudication normally affords."<sup>221</sup> The court further noted:

No other tribunal would be permitted to announce to a party that it has made a decision but that it reserves the right to change its mind for a period of four years. Such a "decision" gives with one hand what it takes away with the other. In effect, it signifies nothing other than that a final decision will not occur for at least four years.<sup>222</sup>

The court also found that allowing the Secretary to exercise the privilege of reopening prior determinations gives rise to serious procedural due process concerns because of the impossibility of formulating a notice that would adequately inform a benefit recipient of the multitude of contingencies that attach once a purportedly favorable determination is made on his claim.<sup>223</sup> Given these significant procedural and substantive due process concerns, the court concluded:

In view of the serious substantive and procedural due process problems that would result from the Secretary's reading of the regulations, we conclude that they should be interpreted as allowing reopening only on the basis of motions by claimants. . . . We find that it would frustrate congressional objectives in passing such a statute [the Act] if the ambiguity in the regulations were to be resolved in favor of putting claimants in a state of limbo for at least four years, uncertain of the final outcome of their cases. . . . This interpretation results in a lack of finality and in the issuance of inevitably misleading notices constructed through selective quotation of ambiguous regulations. This significantly negates the beneficent purposes of the statute.<sup>224</sup>

The Third Circuit has likewise refused to recognize the right of the Secretary to *sua sponte* reopen favorable determinations, again citing constitutional due process concerns. *Chrupcala v. Heckler*<sup>225</sup> holds that once the district court remands a partially favorable determination of a claim for Title II disability insurance benefits pursuant to an appeal filed by a claimant, the Secretary may not revisit issues not raised by the claimant's appeal if the sixty day period for requesting review provided by Section 404.969 has elapsed.<sup>226</sup> In substance,

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220. Note that 20 C.F.R. §§ 404.987-89 (1994) govern the reopening of retirement, disability, and medicare claims.

221. 817 F.2d at 172.

222. 817 F.2d at 173.

223. 817 F.2d at 174.

224. *Id.*

225. 829 F.2d 1269 (3d Cir. 1987).

226. 829 F.2d at 1273. 20 C.F.R. § 404.969 (1994) provides as follows:

Anytime within 60 days after the date of a hearing decision or dismissal, the Appeals Council itself may decide to review the action that was taken. If the Appeals Council does review the hearing decision or dismissal, notice of the action will be mailed to all parties at their last known address.



the court viewed the Secretary's attempt to revisit the entire case upon remand as a veiled attempt to reopen the prior determination.<sup>227</sup> Citing the procedural and substantive due process arguments advanced in *McCuin*,<sup>228</sup> the court implicitly agreed with the First Circuit that common-law doctrines of res judicata and collateral estoppel apply with equal force to administrative proceedings.<sup>229</sup> Hence, the Secretary was precluded from revisiting the case once the sixty day period provided by Section 409.969 had expired.<sup>230</sup>

To summarize, we now have both the First and Third Circuits refusing to recognize the Secretary's authority to *sua sponte* reopen favorable determinations. In each instance, the court cited both procedural and substantive due process concerns. Surprisingly, none of the other appellate tribunals has had occasion to consider the constitutional issues raised in *McCuin* and *Chrupcala*. Nevertheless, one must conclude that the Secretary's practice of *sua sponte* reopening favorable determinations rests on tenuous ground in these remaining circuits in view of the well reasoned constitutional arguments advanced in *McCuin* and *Chrupcala*. Of course, the fact that Section 404.987 now unambiguously states that the Secretary does have *sua sponte* reopening authority has little bearing on this issue, considering the constitutional basis of the First and Third Circuits' refusal to recognize such authority.<sup>231</sup> Furthermore, the constitutional concerns articulated in *McCuin* and *Chrupcala* render this regulatory change invalid in each of these circuits.

The rationales of *McCuin* and *Chrupcala* are correct. The provisional nature of administrative adjudications established by our current regulatory scheme simply does not comport with traditional notions of substantive and procedural due process. Adherence to a more rigid concept of decisional finality is imperative. Thus, the Secretary's authority to disturb prior determinations should be drastically curtailed in keeping with traditional common law notions of res judicata and collateral estoppel. By no means is it necessary to preserve the expanded notion of decisional finality perpetuated by the regulations in order to safeguard the Secretary's legitimate interest in correcting erroneous benefit determinations. The Secretary's concern for decisional accuracy is adequately protected by Section 404.969 which, as noted previously, authorizes the Secretary to institute "on motion review" within sixty days after a decision is rendered.<sup>232</sup>

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227. 829 F.2d at 1273.

228. *Id.*

229. *Id.*

230. *Id.*

231. 20 C.F.R. § 404.987 (1994).

232. 20 C.F.R. § 404.969 (1994).

Contrary to the court's assertion in *Gerstein*,<sup>233</sup> the waiver provisions contained at Sections 404.506-512 fall woefully short of resolving lingering due process concerns considering the somewhat narrowly circumscribed class of benefit recipients to which these regulations apply.<sup>234</sup> Most notably, under the current waiver regulations, individuals who are wholly without fault in causing an overpayment are not, without more, entitled to waiver of adjustment or recovery. These individuals are therefore subject to the contingency that the Secretary may seek to recover benefits paid years after a favorable determination is made on the claim.<sup>235</sup> Without question, due process concerns are seriously implicated when the Secretary attempts to recover paid benefits under such circumstances. The court in *Gerstein* advanced the notion that the waiver regulations adequately safeguard the benefit recipients' interest in decisional finality as these provisions allow "worthy persons" to escape the "long arm" of the Secretary and thus avoid having to reimburse years of paid benefits.<sup>236</sup> How can it be said that a benefit recipient whose conduct did not contribute in any way to the existence of the overpayment is not a "worthy person" entitled to the full complement of due process rights and protections? More to the point, did the *Gerstein* court have a rational basis to support its conscious decision to deny the protections of due process to this rather substantial class of good faith benefit recipients?

One final point is appropriate concerning the analysis in *Gerstein* of the due process issues raised by the court's recognition of the Secretary's authority to *sua sponte* reopen prior determinations. As noted previously,<sup>237</sup> *Gerstein* defines "worthy persons" as individuals entitled to waiver under the applicable regulatory provisions—i.e., individuals without fault whose circumstances are such that adjustment or recovery of overpaid benefits would defeat the purposes of the Act or be against equity and good conscience. Thus, while *Gerstein* fails to extend due process protections to *all* individuals who are free of fault, it does, in all cases, manifestly deny such protections to those individuals who are at fault. Does it not seem a bit curious to tie substantive and, indeed, procedural due process rights to the culpability of the benefit recipient? Does constitutional due process only extend to "worthy persons"?

In view of the above concerns, regulatory change in this area of the law is long overdue. The regulations governing reopening must be amended to abolish the Secretary's right to *sua sponte* reopen prior determinations. As noted previously, Section 404.969 preserves the Secretary's interest in decisional accuracy by providing for a sixty day period within which to reevaluate favorable

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233. See *supra* text accompanying note 217.

234. 20 C.F.R. §§ 404.506-512 (1994).

235. *Id.* See *supra* note 193.

236. The court in *Gerstein* defines "worthy persons" as those individuals entitled to waiver of adjustment or recovery under 20 C.F.R. § 404.506 (1994). See *supra* text accompanying note 217.

237. See *supra* text accompanying note 217.

determinations.<sup>238</sup> By abolishing the Secretary's right to disturb administrative determinations after the expiration of this sixty day period, the claimant's interest in decisional finality will be protected, and the due process concerns articulated in *McCuin* and *Chrupcala* will be laid to rest. Hopefully, some movement in this direction will be seen in the very near future.

## V. CONCLUSION

In *Schweikker v. Gray Panthers*,<sup>239</sup> Justice Powell observed that the Social Security Act was among the most complex bodies of legislation ever adopted by Congress, noting that the Act's byzantine construction rendered it virtually incomprehensible to those untrained in its use.<sup>240</sup> By now, the reader can no doubt appreciate the wisdom of Justice Powell's comments and has perhaps concluded that these observations apply with equal if not greater force to the Secretary's regulations. Unfortunately, however, the many difficult interpretive questions arising from this highly complex and, at times, unintelligible body of laws are not the only uncertainties faced by applicants for retirement benefits and those who endeavor to represent their interests. In the absence of any statutory or regulatory guidance on this important issue, the courts have adopted two hopelessly irreconcilable standards for vitiating wage shifting schemes and the Secretary, curiously enough, has endorsed by ruling each such standard!

The regulations governing the reopening of prior determinations raise still additional concerns for retirees as these provisions relegate benefit recipients to provisional entitlement status for a period of up to four years by authorizing the Secretary to *sua sponte* reopen favorable determinations during such period for good cause. Predictably, these provisions have not survived constitutional scrutiny in two circuits, and when confronted with this issue, most if not all of the remaining circuits will probably likewise refuse to recognize the Secretary's reopening authority in light of the substantive and procedural due process concerns arising from the practice.

To conclude, the reader will likely infer from this article that there exists a strong undercurrent of uncertainty throughout much of social security retirement and overpayment law. This uncertainty, of course, operates to the detriment of present and future retirees who have consequently been cast as players in a multi-million dollar benefit program with no clear set of rules. This being the case, it is hoped that this article will provide a measure of guidance to the private practitioner when confronted with questions of retirement or overpayment law and perhaps serve as the impetus for much needed regulatory change.

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238. 20 C.F.R. § 404.969 (1994).

239. 453 U.S. 34, 101 S. Ct. 2633 (1981).

240. *Id.* at 43, 101 S. Ct. at 2640.