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Reducing the Employment Tax Burden on Tenure Buyouts

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REDUCING THE EMPLOYMENT TAX BURDEN ON TENURE BUYOUTS

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Colleges and universities have utilized the purchase of faculty tenure for a variety of reasons ranging from efforts to meet decreased salary budgets to encouraging the turnover of existing faculty.[1] In reviewing the purchase of tenure rights from faculty members, the Internal Revenue Service (IRS) has taken the position that payments made to tenured faculty members for termination of their tenure are subject to the provisions of the Federal Insurance Contribution Act (FICA).[2] Several institutions challenged the IRS's position by asserting that payments to terminate tenure constitute the purchase of a property interest and are therefore not subject to FICA taxation.[3] Resolution of these conflicting positions centers on the determination of whether the tenure "buy-out" payments represent the purchase of a property interest, which presumably is not subject to FICA taxation or whether the payments represent wages, which are subject to FICA taxation.[4]

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1. N.D. State Univ. v. United States, 255 F.3d 599, 601 (8th Cir. 2001). Various factors are considered by institutions when purchasing the faculty tenure such as past performance, current salary, curriculum needs, and budget restraints. *Id.*

2. *Id.* at 602. Following an audit of North Dakota State University (NDSU), the Internal Revenue Service assessed deficiencies in FICA taxes on NDSU's purchase of faculty tenure. *Id.* The Commissioner of the Internal Revenue Service has formally announced its "nonacquiescence" to the decision issued by the Eighth Circuit. N.D. State Univ. v. United States, 84 F. Supp. 2d 1043 (D.N.D. 1999), *aff'd* 255 F.3d 599 (8th Cir. 2001); 2001-53 I.R.B. 631 (Dec. 31, 2001). The Commissioner of the Internal Revenue Service defines "nonacquiescence" as follows: "although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers." 2001-53 I.R.B. 631. With respect to a decision of a circuit court of appeals, the Commissioner's issuance of a notice of "nonacquiescence" indicates that the Service will not follow the holding on a nationwide basis but will recognize the precedential impact of the opinion within the circuit in which the opinion was issued. *Id.*

3. *See, e.g., N.D. State Univ.*, 255 F.3d at 600-09.

4. *Id.* As noted by the Eighth Circuit of Appeals, "[t]he crux of this case is whether payments made to tenured faculty, in exchange for which the tenured faculty gave up their tenure rights, are subject to FICA taxes as defined by the Internal Revenue Code." *Id.* at 603. The Eighth Circuit noted that it believed the issue was one of first impression in the federal circuit courts and that the only case that had previously addressed the issue was an unpublished decision from the Southern District of Texas. *Id.* at 604 n.7 (citing Slotta v. Tex. A & M Univ. Sys., No.

One institution subjected to the IRS's scrutiny of tenure purchase transactions was North Dakota State University (NDSU).[5] The IRS concluded payments for the purchase of tenure were wages subject to FICA taxation and thereafter assessed additional FICA taxes.[6] NDSU paid the assessed taxes, exhausted its administrative remedies, and initiated a refund suit for the recovery of the additional FICA taxes that had been paid.[7] Following cross motions for summary judgment, the Federal District Court for the District of North Dakota entered partial judgment in favor of NDSU after determining payments received by tenured faculty members for the purchase of a property interest (tenure) were not wages for FICA tax purposes.[8] The district court entered judgment in favor of the Government on the remaining issue of whether payments made to administrators were wages subject to the FICA tax.[9] Both parties initiated an appeal from the decision of the district court.[10] The Eighth Circuit Court of Appeals affirmed the decision of the district court in all respects.[11]

I. FACTUAL HISTORY

NDSU is a publicly-funded institution of higher education located in Fargo, North Dakota.[12] During the tax years at issue, NDSU maintained an

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G-93-92, 1994 U.S. Dist. LEXIS 21205 (S.D. Tex. Aug. 10, 1994)). The Eighth Circuit limits the authoritative value of unpublished decisions. EIGHTH CIR. RULES AND PROC., R. 28A(i).

5. *N.D. State Univ.*, 255 F.3d at 600-09.

6. *Id.* at 602.

7. *Id.* NDSU has had an on again off again policy with regard to payment of FICA taxes on the purchase of tenure. *Id.* at 602. Prior to 1991, the employee's portion of FICA taxes was withheld from the tenure purchase payments, and NDSU paid the employer's share of the FICA taxes. *Id.* After NDSU's payroll department received several inquiries questioning the applicability of FICA taxes to the tenure purchase payments, NDSU's payroll director and general counsel researched the issue by reviewing privately published tax law treatises, attempting to contact the Internal Revenue Service, and initiating contact with the Social Security Administration. *Id.* Following this investigation, NDSU stopped both the withholding and payment of FICA taxes on the tenure purchase payments. *Id.* In June of 1995, the Internal Revenue Service assessed deficiencies in FICA taxes for the years 1991 through 1994 as the result of NDSU's decision to stop withholding and paying FICA taxes on the tenure purchase payments. *Id.* NDSU paid the assessment and once again began to withhold and pay FICA taxes on the tenure buyout payments. *Id.* Ultimately, NDSU filed a request for an administrative refund of the FICA taxes for the periods of 1991 through 1997, which was denied by the Internal Revenue Service. *Id.*

8. *N.D. State Univ.*, 84 F. Supp. 2d at 1044-45.

9. *Id.*

10. *N.D. State Univ.*, 255 F.3d at 602. The United States appealed the district court's ruling that payments to tenured faculty members were not wages for FICA purposes because the faculty members had a recognized property interest in their tenure. *Id.* NDSU appealed the District Court's ruling that payments made to administrators who also held tenure rights were deemed wages for FICA purposes. *Id.* NDSU conceded at oral argument that non-tenured administrators were at-will employees and subject to FICA taxation. *Id.* at 603.

11. *Id.* at 602-03.

12. *N.D. State Univ.*, 84 F. Supp. 2d at 1045.

early retirement program for tenured professors and high level administrators.[13]

The early retirement program served as a management tool to be used to make personnel changes.[14] NDSU used the program to deal with budgetary problems, curriculum needs, and occasionally to encourage individuals to terminate employment when there was insufficient cause for dismissal.[15] NDSU has utilized the early retirement program more frequently when budgets have been tight.[16]

Eligibility for the early retirement program is defined by the North Dakota Board of Higher Education Policy § 703.1 and NDSU Policy § 360.[17] Participation in the early retirement program "is not an entitlement but requires mutual agreement and written consent of both the employee and the administration."[18] Neither NDSU nor the tenured faculty member or administrator can unilaterally demand participation in the program; instead, both parties must mutually agree and consent to participation.[19]

After a determination is made that an individual is eligible to participate in the program, NDSU determines whether or not it would be in its best interest to enter into such an agreement with that particular individual.[20] Generally, a dean, vice-president, or department chair will negotiate the agreement between NDSU and the retiring employee.[21] As part of the early retirement agreement, employees agree to give up their tenure rights and/or other contract rights, agree not to seek employment with any other North Dakota public university or college, and further agree to waive any claim they may have under the Age Discrimination in Employment

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13. *Id.*

14. *Id.* at 1045-46.

15. *Id.* at 1050-52.

16. *Id.* at 1045.

17. N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1 Early Retirement; N.D. STATE UNIV. POLICY MANUAL § 360. North Dakota Board of Higher Education Policy § 703.1 provides that the early retirement program is for the mutual benefit of the employee and the institution. N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1(2)(a).

18. N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1(2)(b).

19. *Id.*; *see also* N.D. State Univ. v. United States, 255 F.3d 599, 601 (8th Cir. 2001). To participate in the program, the sum of the employee's age and total years of employment must equal or exceed 70. N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1(3)(b)(II); *N.D. State Univ.*, 255 F.3d at 601. From January 1, 1993 through June 30, 1997, the North Dakota Board of Higher Education lowered the eligibility requirement to 65 years. *N.D. State Univ.*, 84 F. Supp. 2d at 1045 n.3; N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1(3)(b)(V). The North Dakota Board of Higher Education Policy Manual noted that the reduction from 70 years to 65 years was a "one time option to assist the institutions and Board in meeting anticipated staffing reductions due to shortages in appropriations." N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1(3)(b)(V).

20. N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1(3)(b)(V).

21. *Id.*

Act.[22] All tenured faculty members and administrators typically have contracts with NDSU.[23] The rights of an employee under those contracts are outlined in North Dakota Board of Higher Education (NDBHE) and NDSU policies regarding dismissal of tenured academic staff or dismissal of non-classified non-academic staff (administrators).[24]

While it is possible for the prospective retiree to receive a payment equal to 100% of his or her final year's salary, he or she is not entitled to a 100% payment, and amounts received have varied.[25] Many factors are considered in determining the retirement payment amount.[26] While past performance, current salary, the curriculum needs of NDSU and the available budget are considered in determining the amount of the payment, those factors are not the only considerations and there are no restrictions on the factors that a negotiating officer may consider.[27]

Absent an agreement to voluntarily relinquish tenure, a tenured faculty member may be dismissed only based upon demonstratively bona fide financial exigency, loss of legislative appropriations, loss of institutional or program enrollment, consolidation of academic units or program areas, or elimination of courses.[28] A tenured faculty member may also be dismissed for adequate cause.[29] Adequate cause means demonstrated incompetence or dishonesty, continued unsatisfactory performance and failure to respond to a recommended plan for improvement, substantial manifest neglect of duty, conduct substantially impairing the individual's ability to fulfill his or her responsibilities, physical or mental inability to perform duties, or significant

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22. *N.D. State Univ.*, 84 F. Supp. 2d at 1045-46. The North Dakota State Board of Higher Education Policy Manual provides that by agreeing to the early retirement, the employee waives all tenure rights and the employee is further precluded from employment with other institutions within the North Dakota higher education system. N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1(3)(a)(I) & (b)(I).

23. N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1(3)(a)(I) & (b)(I).

24. *Id.*

25. *N.D. State Univ.*, 84 F. Supp. 2d at 1045; N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 703.1(3)(b)(II).

26. *N.D. State Univ.*, 84 F. Supp. 2d at 1045.

27. *Id.* at 1046.

28. *Id.* Generally, "No protected property interest is implicated when an employer reassigns, or transfers an employee absent a specific statutory provision or contract term to the contrary." Hulen v. Yates, 322 F.3d 1229 (10th Cir. 2003) (quoting Anglemyer v. Hamilton County Hosp., 58 F.3d 533, 539 (10th Cir. 1995)). Absent a specific statutory provision or contract term, tenured university professors may be moved from one department to another without disturbing a protected property interest. *Hulen*, 322 F.3d at 1240. *See also* Huang v. Bd. of Governors of the Univ. of N.C., 902 F.2d 1134, 1142 (4th Cir. 1990); Maples v. Martin, 858 F.2d 1546, 1551 (11th Cir. 1988).

29. Morris v. Clifford, 903 F.2d 574, 576 (8th Cir. 1990). The regulations on governing higher educational institutions in North Dakota on academic tenure and due process are contained in the Faculty Handbook provided to tenured faculty members. *Id.*

and continued violations of Board and University policies.[30] Tenured faculty members are also entitled to due process rights, such as a notice and hearing before the standing committee on faculty rights before dismissal.[31]

Initially, NDSU withheld and paid FICA taxes on tenure buyout payments.[32] Several of the buyout participants questioned NDSU's duty to withhold FICA taxes during 1991.[33] NDSU's payroll director sought guidance from the Social Security Administration (SSA) on the requirement to withhold.[34] The SSA responded to NDSU's inquiry regarding the withholding obligation on tenure buyout payments by noting that the "payment to secure the release on the unexpired contract of employment" is not considered wages by the SSA for determining the amount of benefits or for deduction of benefit purposes.[35] After receiving the response from the SSA that the SSA did not consider the payments to be wages, NDSU stopped withholding and paying FICA taxes on the tenure buyout payments.[36]

II. PROCEDURAL HISTORY

In 1995 the IRS conducted an audit of NDSU.[37] Following the audit the IRS asserted that NDSU had underpaid its FICA tax liability for all four quarters for the years 1991 through 1994 with respect to the tenure buyout payments.[38] NDSU paid the assessed deficiency and once again initiated withholding of FICA taxes on the tenure buyout payments.[39] After paying the deficiency, NDSU filed for a refund of the FICA taxes for the 1991 through 1997 tax periods.[40]

Section 6511 of the Internal Revenue Code provides the basic framework for the refund of an overpayment of tax.[41] In this instance,

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30. *N.D. State Univ.*, 84 F. Supp. 2d at 1045; *see also Morris*, 903 F.2d at 576.

31. *N.D. State Univ.*, 84 F. Supp. 2d at 1045.

32. N.D. State Univ. v. United States, 255 F.3d 599, 602 (8th Cir. 2001). NDSU has had an "on again off again" policy with regard to withholding FICA tax on tenure buyouts. *See supra* note 7 and accompanying text.

33. *N.D. State Univ.*, 255 F.3d at 602.

34. *Id.* NDSU's payroll director and general counsel also consulted privately published tax law treatises and attempted to initiate contact with the Internal Revenue Service. *Id.*

35. *Id.* NDSU framed the question as whether its "'tenure buy-out program,' under which 'an employee is offered a sum of money to sell their tenure back to the university,' is considered wages for FICA purposes." *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. I.R.C. § 6511 (2004). Section 6511(b)(1) provides that "no credit or refund shall be allowed or made after the expiration of the period of limitations prescribed . . . for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such

NDSU timely paid the additional assessments and subsequently filed claims for refund with the IRS.[42] Because the Secretary of the Treasury failed to respond to the claims for refund within six months of the date that they were filed, the claims for refund were deemed to have been administratively denied and NDSU was allowed to initiate an action to secure a refund in the Federal District Court for the District of North Dakota.[43]

After initiation of the litigation, the Government filed a motion for summary judgment asserting that payments made to terminate an employee's tenure were wages subject to FICA taxation.[44] On September 7, 1999 NDSU timely filed a response to the Government's motion for summary judgment seeking summary judgment in its favor.[45] NDSU argued that the payments compensated the employees for the termination of a valuable property interest, their tenure, and therefore were not wages subject to FICA Taxation.[46] NDSU further asserted that in the event the district court determined that the payments were subject to FICA taxation NDSU was entitled to relief pursuant to the "deputy tax collector" doctrine because it did not have clear and precise notice of its requirement to withhold FICA taxes.[47]

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period." *Id.* § 6511(b)(1). A claim for refund is timely if the claim is filed within three years from the date the return was filed or within two years from the time the tax was paid, whichever is later. *Id.* § 6511(b)(2).

42. *Id.* § 6511(a). Claims for refund of employment taxes are made on Form 843. Completion of Form 843 requires identification information for the taxpayer, the tax periods involved, the amount to be refunded or abated, identification of the type of tax, identification of the type of return that was filed, identification of the dates of payment, and an explanation as to why the taxpayer believes the claim should be allowed. Care should be taken in drafting a claim for refund because a subsequent refund suit is required to be based on the same grounds as stated in the claim for refund. *See, e.g.*, Iowa 80 Group, Inc. & Subsidiaries v. United States, 203 F. Supp. 2d 1058 (S.D. Iowa 2002) (noting the Internal Revenue Service is not required to "ferret out" the claims that are being asserted by the taxpayer). The requirement to state the basis for the claim is intended to provide the Internal Revenue Service with an opportunity to investigate the grounds the taxpayer asserts entitle the taxpayer to a refund at the administrative level. I.R.C. § 7422(a) (2002); 26 C.F.R. § 301.6402-2(b)(1) (2002). A claim for refund is required to set forth in detail each ground upon which the taxpayer asserts a credit or refund is due and in a manner that asserts sufficient facts to appraise the Commissioner of the exact basis for the refund claim. 26 C.F.R. § 301.6402-2(b)(1).

43. I.R.C. § 6532(a) (2002). A refund suit may be initiated any time within two years after the date the IRS has disallowed the claim. *Id.* A claim for refund is deemed to have been denied if no action is taken by the Secretary within six months after the filing of the claim. *Id.* The United States district courts and the Court of Federal Claims have jurisdiction over suits to recover to IRS taxes that are alleged to have been erroneously or illegally assessed and/or collected. 28 U.S.C. § 1346(a)(1) (2002).

44. N.D. State Univ. v. United States, 84 F. Supp. 2d 1043, 1044 (D.N.D. 1999).

45. *Id.*

46. *Id.* at 1050.

47. *Id.* at 1053.

On November 19, 1999, the district court, the Honorable Rodney S. Webb presiding, issued its Memorandum Decision and Order.[48] The district court concluded that tenure establishes a constitutionally protected property interest in continued employment.[49] The district court thereafter concluded that tenure was akin to a contract right and, "[c]onsequently, a payment for relinquishing tenure rights is a payment for the purchase of a property interest."[50] "As a purchase of a property interest, the payment is not a 'wage' or 'remuneration for services' and thus not subject to FICA taxation."[51] Based upon these determinations the district court concluded that NDSU was not required to withhold FICA taxes or payments made for the purpose of terminating an employee's tenure.[52]

Several other individuals who received payments under the early retirement program were administrators.[53] The district court concluded that those individuals were employees at-will and did not have a property interest in their position.[54] Based upon this determination, the district court concluded "the payments made to tenured administrators [under the early retirement program] are wages for FICA withholding purposes."[55]

III. FICA TAX STRUCTURE

The structure for imposing FICA tax is codified in §§ 3101 through 3128 of Chapter 21 of the Internal Revenue Code.[56] The FICA tax is imposed upon wages[57] and is deducted by the employer from each payment of wages made to an employee.[58] Every employer that provides a payment of wages to employees is required to deduct and withhold from the employees' wages FICA taxes.[59] Included within the FICA tax are the old age, survivor and disability insurance (OASDI), and hospital insurance (HI).[60] The FICA

48. *Id.*
49. *Id.* at 1051.
50. *Id.*
51. *Id.* at 1052.
52. *Id.*
53. *Id.* at 1048.
54. *Id.*
55. *Id.*
56. I.R.C. § 3101, *et seq.* (2002).
57. *Id.* § 3121(a).
58. *Id.* § 3102(a).
59. *Id.* § 3402(a)(1).
60. *Id.* §§ 3101, 3111. The burden imposed by employment taxes has steadily increased throughout its history. *See id.* § 3101 (setting forth the history of the employment tax rate imposed on employees); *see also id.* § 3111 (setting forth the history of the employment tax rate imposed on employers). In 1937, the combined OASDI and HI taxes imposed on an employee were equal to 1% of the taxable wage base and have increased to their current combined level of 7.65%. *See id.* § 3101 (setting forth the history of the self-employment tax rate imposed on

tax withheld from wage payments to employees is subject to a matching FICA tax on the employer.[61]

Inherent in determining the applicability of the FICA tax is determination of an employee/employer relationship[62] and the determination of whether the payments constitute wages.[63] NDSU conceded the employer/employee relationship but challenged the Internal Revenue Service's determination that the tenure buyout payments constituted wages.[64]

The definition of "wages" has remained relatively unchanged since the original definition appeared in 1935.[65] Wages are defined for purposes of the Internal Revenue Code as "all remuneration from employment."[66] While Section 3121 provides a number of specific exceptions to the definition of wages,[67] the scope of FICA taxation has been broadly construed.[68]

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employees). The combined rate (employer and employee obligations) now imposed upon employees and employers is 15.3% of the taxable wage base. *Id.* §§ 3101, 3111.

61. *Id.* § 3111.

62. *Id.* § 3121(d) (defining the term "employee" for purposes of FICA taxation). The common law factors are applied in determining whether an employer-employee relationship exists. Treas. Regs. §§ 31.3401(c)-1(B), 31-3121(d)-1(C)(2), 31.3306(i)-1(b) (2004). Although the common law test for determining employee or independent contractor status has been expressed in a variety of formulations, the underlying issue is whether or not there is control over the individual providing services. It should also be noted that the FICA tax regulations specifically referred to the right to discharge, the employer providing tools and the employer providing a place to work as factors indicating an employer-employee relationship. Treas. Reg. §§ 31.3401(c)-1(B), 31.3401(d)-1, 31.3121(d)-1(C), 31.3306(i)-1. Common law factors have been described in various revenue rulings issued by the Internal Revenue Service. *See, e.g.*, Rev. Rul. 87-41, 1987-1 C.B. 296. Similarly, courts have outlined a variety of factors to determine the employer-employee relationship. *See, e.g.*, LEB's Enter., Inc. v. United States, 85 A.F.T.R.2d 00-886 (N.D. Ill. 2000) (setting forth factors or elements to determine if sufficient control is present to establish employee-employer relationship); Vizcaino v. United States Dist. Ct. W.D. of Wash., 173 F.3d 713, 723 (9th Cir. 1999) (outlining factors to determine the employer-employee relationship). Compensation in excess of the social security and unemployment wage base, accident and disability payments, moving expenses, fringe benefits, dependent care assistance, group legal services, group term life insurance, employer reimbursements, death benefits, combat zone compensation, non-cash remuneration and de minimis amounts are not subject to withholding requirements. I.R.C. § 3121(a) (2002).

63. *Id.* Generally, all compensation derived from employment, unless otherwise excluded, is considered wages. *Id.*

64. N.D. State Univ. v. United States, 84 F. Supp. 2d 1043, 1048 (D.N.D. 1999). The district court framed the question as follows: "determining whether the early retirement payments made to administrators and tenured faculty members were wages for purposes of FICA taxation." *Id.*

65. The Social Security Act of 1935, Pub. L. No. 74-271, § 210, 49 Stat. 620, 625 (1935).

66. I.R.C. § 3121(a).

67. *Id.* Deferred compensation benefits are excluded from the definition of wages for the purposes of the FICA tax. *Id.* § 3121(a)(5). Accident and disability payments are generally subject to FICA tax but will not be subject to FICA tax if paid pursuant to a workman's compensation statute, attributable to a benefit resulting from the employee's payment of the accident or disability premiums, or the benefits are paid after the expiration of six calendar months following the employee's employment. *Id.* § 3121(a), (a)(2), (a)(4). Moving expenses are generally excluded from FICA taxation. *Id.* § 3121(a)(11). Fringe benefits that are excluded from

Section 3121 defines wages as follows: "the term 'wages' means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash . . . ."[69] The employer's designation placed on the payment such as "salary," "fees," "bonuses," "commissions," or other identification is not relevant for determining whether the payment is considered wages.[70] Additionally, the median and/or manner in which the employer pays the compensation is not relevant to determining whether the FICA tax applies.[71] Compensation in

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an employee's taxable income are excluded from FICA taxation. *Id.* § 3121(a)(20). Dependent care assistance is excludable from FICA taxation if the payment is excludable from the employee's taxable income. *Id.* § 3121(a)(18). Employer paid group term life insurance is not subject to FICA taxation. *Id.* § 3121(a)(2). The reimbursement of ordinary and necessary expenses by the employer to an employee is not subject to FICA taxes. Treas. Reg. 31.3121(a)-1(h) (2004). Death benefits paid by an employer on behalf of an employee or the employee's dependants are exempt from FICA taxation. I.R.C. § 3121(a)(2), (13).

68. Soc. Sec. Bd. v. Nierotko, 327 U.S. 358 (1946). The United States Supreme Court noted that the term "wages" was to be broadly interpreted and extends even to non-productive activity. *Id.* at 365-66. The broad judicial interpretation of the term "wages" is consistent with congressional intent to protect beneficiaries of the FICA tax structure by ensuring that an expansive range of remuneration is captured within the FICA tax structure. United States v. Silk, 331 U.S. 704, 714 (1947); Halvering v. Davis, 301 U.S. 619, 641 (1937). Congress expressed its intent to broadly define employer-furnished remuneration in order to further advance the remedial purposes of the Social Security Act. H.R. REP. NO. 74-615, 1st Sess. 3 (1935), *reprinted in* 1939-2 C.B. 600, 601; *Halvering*, 301 U.S. at 641; *Silk*, 331 U.S. at 712. The United States Supreme Court in *Silk* noted that a restrictive interpretation of the terms used within the Social Security Act "would only make for a continuance, to a considerable degree, of the difficulties for which [social security] was devised and would invite adroit schemes by some employers and employees to avoid the immediate burden at the expense of the benefit sought by the legislature." *Silk*, 331 U.S. at 712. The legislative history for the Social Security Act amendments of 1983, Pub.L. No. 98-21, 97 Stat. 65 further confirms the broad scope with which the term "wages" is intended to apply by noting the following:

> The Social Security program aims to replace the income of beneficiaries when that income is reduced on account of retirement and disability. Thus, the amount of 'wages' is the measure used both to define income which should be replaced and to compute FICA tax liability. Since the security system has objectives which are significantly different from the objective underlying the income tax withholding rules, the committee believes that the amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion.

S. REP. NO. 98-23, at 42, *reprinted in* 1983 U.S.C.C.A.N. 143, 183; H.R. REP. NO. 98-25, Pt. 1 at 80, *reprinted in* 1983 U.S.C.C.A.N. 219, 299.

69. I.R.C. § 3121(a).

70. Treas. Reg. § 31.3121(a)-(c) (2004). All "compensation for employment" is subject to the withholding requirements of FICA and FUTA, regardless of what the compensation is called. Lane Processing Trust v. United States, 25 F.3d 662, 665 (8th Cir. 1994) (citing 26 CFR § 31.3121(a)-1(C) (2004)). "Regardless of the name given to the payment, a payment constitutes 'wages' when given as remuneration for employment." Greenwald v. United States, 85 A.F.T.R.2d 00-766 (S.D.N.Y. 2000).

71. Treas. Reg. § 31.3121(a)-(e). In determining whether or not remuneration to an employee constitutes wages, it is generally immaterial how payment is made. STA of Baltimore-ILA Container Royal Fund v. United States, 621 F. Supp. 1567, 1575 (D. Md. 1985).

excess of the social security and unemployment wage base is exempt from the FICA tax.[72]

IV. TENURE RIGHTS ARE A PROPERTY INTEREST WHICH FALLS OUTSIDE THE SCOPE AND DEFINITION OF THE TERM "WAGES"

A. TENURE IS A PROTECTED PROPERTY INTEREST

Despite the intent to broadly construe the term "wages" for purposes of FICA taxation, NDSU asserted that the purchase of tenure is not the payment of "wages" and is instead the purchase of a property interest, which is not subject to the duty to withhold FICA taxes.[73] In *Morris v. Clifford*,[74] the Eighth Circuit had previously acknowledged that a tenured faculty member can be dismissed only for adequate cause and that a tenured faculty member has a constitutionally protected property interest in continued employment.[75] The *Morris* decision, which cites several Eighth Circuit and U.S. Supreme Court decisions, recognized that a tenured faculty member has a constitutionally protected property interest in continued employment.[76] In addition to procedural due process rights, a tenured faculty member also has substantive due process rights "to be free from discharge for reasons that are 'arbitrary and capricious,' or in other words, for reasons that are trivial, unrelated to the education process, or wholly unsupported by basis in fact."[77] Given the substantial procedural and substantive due process rights, a tenured faculty member can only be terminated for "adequate cause."[78] In *Morris*, a University of North Dakota

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72. I.R.C. § 3121(a)(1).

73. N.D. State Univ. v. United States, 84 F. Supp. 2d 1043 (D.N.D. 1999), *aff'd*, 255 F.3d 599 (8th Cir. 2001).

74. 903 F.2d 574 (8th Cir. 1990).

75. *Morris*, 903 F.2d at 576.

76. *Id.* at 576 (citing Moore v. Warwick Pub. Sch. Dist., 794 F.2d 322, 328-30 (8th Cir. 1986); Agarwal v. Regents of the Univ. of Minn., 788 F.2d 504, 507-08 n.2 (8th Cir. 1986); Stermetz v. Harper, 763 F.2d 366, 367 (8th Cir. 1985); O'Neal v. City of Hot Springs Nat'l Park, 756 F.2d 61, 62-63 (8th Cir. 1985); Miller v. Dean, 552 F.2d 266, 268 (8th Cir. 1977); Fisher v. Snyder, 476 F.2d 375, 376-77 (8th Cir. 1977)); *see generally*, Harrah Indep. Sch. Dist. v. Martin, 440 U.S. 194, 197 (1979).

77. *Morris*, 903 F.2d at 577 (citing *Fisher*, 476 F.2d at 377-78; Honore v. Douglas, 833 F.2d 565, 568-69 (5th Cir. 1987); Garquil v. Thompkins, 704 F.2d 661, 667-69 (2d Cir. 1983), *vacated on other grounds*, 465 U.S. 1016 (1984)).

78. *Id.*

faculty member was determined to have a protective property interest, and "adequate cause" existed to terminate the employee.[79]

Decisions establishing tenure as a protective property interest are not limited to North Dakota institutions.[80] For example, in *Agarwal v. Regents of University of Minnesota*,[81] the Eighth Circuit Court recognized that a tenured faculty member has a protected property interest in continued employment.[82] In *Agarwal*, the Eighth Circuit Court recognized that the protected property interest prevents dismissal of a tenured faculty member without due process.[83]

State law establishes the existence of a property interest.[84] While state law establishes the property interest, federal constitutional law determines whether a particular state law property interest rises to the level of a constitutionally protected property interest.[85] In order to prevail on a claim that a person's substantive due process has been unconstitutionally denied, the claimant must first establish that they had a property or liberty interest at stake.[86]

Although the existence of a property interest in continued employment has been recognized by many courts, because the NDSU decision arises in North Dakota, it is helpful to briefly discuss property interests in the

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79. *Id.* at 576-77. *See also* Thompson v. Peterson, 546 N.W.2d 856, 863 (N.D. 1996) (citing Morris v. Clifford for the proposition that a tenured faculty member cannot be dismissed unless there is adequate cause and holding that a tenured faculty member has a protected property interest).

80. *See, e.g.*, Board of Regents of State Colls. v. Roth, 408 U.S. 564, 576-77 (1972). In *Roth*, the United States Supreme Court summarized its decisions upholding the procedural due process safeguards applicable to tenured faculty members. *Id.* at 576-77 (citing Slochower v. Bd. of Educ., 350 U.S. 551 (1956); Wieman v. Updegraff, 344 U.S. 183 (1952)). *See also Moore*, 794 F.2d at 328-30; *Stermetz*, 763 F.2d at 367; *O'Neal*, 756 F.2d at 62-63; *Miller*, 552 F.2d at 268; *Fisher*, 476 F.2d at 376-77.

81. 788 F.2d 504 (8th Cir. 1986).

82. *Agarwal*, 788 F.2d at 507 n.2. Public employees who can only be discharged for cause have constitutionally protected property interest and their tenure cannot be terminated without due process. *Roth*, 408 U.S. at 578; Gilbert v. Homar, 520 U.S. 924, 928-29 (1997).

83. *Agarwal*, 788 F.2d at 507 n.2. (citing *Roth*, 408 U.S. at 576-77).

84. *See, e.g.*, Riley v. St. Louis County of Mo., 153 F.3d 627, 630 (8th Cir. 1998); Eddings v. City of Hot Springs, Ark., 323 F.3d 596, 601 (8th Cir. 2003) (citing Bishop v. Wood, 426 U.S. 341, 344-45 (1976)).

85. Dover Elevator Co. v. Ark. State Univ., 64 F.3d 442, 446 (8th Cir. 1995).

86. United States v. Wilson, 316 F.3d 506, 510 (4th Cir. 2003) (citing Smith v. Ashcroft, 295 F.3d 425, 429 (4th Cir. 2002)). States and other political subdivisions are prohibited by the 14th Amendment to the United States Constitution from "deprive[ing] any person of life, liberty, or property without due process of law." U.S. CONST. amend. XIV, § 1; Jocham v. Tuscola County, 239 F. Supp. 2d 714, 726 (E.D. Mich. 2003). A claimant is not entitled to substantive due process under the 14th Amendment of the United States Constitution unless the claimant has a cognizable life, liberty, or property interest at stake. Ashki v. I.N.S., 233 F.3d 913, 921 (6th Cir. 2000). The United States Constitution does not create an abstract federal due process right for the sake of due process itself. Seal v. Morgan, 229 F.3d 567, 574 (6th Cir. 2000).

employment context in North Dakota.[87] In *Hennum v. City of Medina*,[88] relying upon United States Supreme Court case law, the North Dakota Supreme Court recognized a distinction between at-will employees and employees with a protected property interest.[89] The North Dakota Supreme Court recognized that property interests are not created by the Constitution but are instead created and defined by existing rules or understandings that stem from an independent source.[90]

In *Rudnick v. City of Jamestown*[91], the North Dakota Supreme Court recognized that employees with protected property interests are entitled to other protections not afforded to an employee at-will.[92] In *Livingood v. Meece*,[93] the North Dakota Supreme Court again held that a property interest could be created in continued employment.[94] The North Dakota Supreme Court recognized that property interests could be created by statutes, regulations, ordinances, or implied contracts.[95] Personnel policies contained in employee handbooks or manuals can also create a property interest in continued employment.[96] In *Livingood*, the North Dakota Supreme Court noted that the North Dakota Personnel Policy Manual could potentially be the basis of a constitutionally protected property interest.[97]

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87. To establish a due process violation in the context of public employment, the claimant is first required to show a cognizable property interest in continued employment. *See* Cleveland Bd. of Educ. v. Loudermill, 470 U.S. 532, 538, (1985); Bishop v. Wood, 426 U.S. 341, 344 (1976). A number of states have recognized a protected property interest in employment contracts and/or tenure. *See, e.g.*, Bluitt v. Houston Indep. Sch. Dist., 236 F. Supp. 2d 703, 731 (S.D. Tex. 2002) (both parties agreed claimant employed under an HISD contract had a protected property interest in employment); Sharp v. Lindsey, 285 F.3d 479, 487 (6th Cir. 2002) (recognizing a protected property interest created by Tennessee's Teacher Tenure Act); TENN. CODE ANN. § 49-5-501(10) (2003)); Mills v. Steger, 179 F. Supp. 2d 637, 644 (W.D. Va. 2002) (manager of public radio station owned by Virginia Polytechnic Institute and State University had a protective property interest); Spagnola v. State Bd. of Agric., 13 Fed. Appx. 870, 872 (10th Cir. 2001) (tenured professional in Colorado had a protected property interest); Trimble v. W. Va. Bd. of Dir., 549 S.E.2d 294, 301 (W. Va. 2001) (recognizing a constitutionally protected property interest in tenured teaching positions); State Tenure Comm'n v. Page, 777 So.2d 126, 131 (Ala. Civ. App. 2000) (acknowledging four requirements necessary to afford minimal due process to a teacher); Panzella v. River Trails Sch. Dist. 26, 729 N.E.2d 954, 958-59 (Ill. App. Ct. 2000) (acknowledging that the School Code provides that a tenured teacher may only be discharged for cause); Wuest v. Whinner School Dist. 59-2, 607 N.W.2d 912, 918 (S.D. 2000) (state law provides a tenured teacher with a protected property interest).

88. 402 N.W.2d 327 (N.D. 1987).

89. *Hennum*, 402 N.W.2d at 335 (citing *Roth*, 408 U.S. at 578).

90. *Id.* (citing *Roth*, 408 U.S. at 578).

91. 463 N.W.2d 632 (N.D. 1990).

92. *Rudnick*, 463 N.W.2d at 638.

93. 477 N.W.2d 183 (N.D. 1991).

94. *Livingood*, 477 N.W.2d at 192.

95. *Id.* at 193 (citing Cleveland Bd. of Educ. v. Loudermill, 470 U.S. 532, 538 (1985); Bishop v. Wood, 426 U.S. 341, 344 (1976)).

96. *Id.*

97. *Id.* (citing Little v. Spaeth, 394 N.W.2d 700, 704 (N.D. 1986)).

B. THE PURCHASE OF A PROPERTY RIGHT IS NOT REMUNERATION FOR SERVICES

Tenure is a property interest, which entitles a tenured faculty member to continued employment.[98] A tenure buy-out is therefore arguably a purchase of a property right and is not remuneration for services.[99] While the payment to the tenured faculty member is undoubtedly income, it does not constitute wages for purposes of employment taxation.[100] Two revenue rulings, a number of private letter rulings, and several court opinions have been issued on the subject of whether the purchase of an individual's property interest in continued employment is considered wages.[101]

In Revenue Ruling 58-301, the taxpayer had an employment contract for a period of five years.[102] In the second year of the employment, the taxpayer and the employer agreed to cancel the remaining period of the contract.[103] In consideration for the cancellation of the contract, the employer provided payment to the employee.[104] The IRS ruled that the payment constituted *income* to the employee but was not *wages* for federal employment and income tax withholding purposes.[105] Revenue Ruling 58-

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98. Morris v. Clifford, 903 F.2d 574, 576 (8th Cir. 1990). *See also* Bd. of Regents v. Roth, 408 U.S. 565, 573-75 (1972). Property interests "are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law." *Id.* at 577. The constitutionally protected property interests are derived from statutes, ordinances, contracts, implied contracts, and other rules that may be developed by state officials. *Id.* at 577-78; Cleveland Bd. of Educ. v. Loudermill, 470 U.S. 532, 538 (1985); Perry v. Sinderman, 408 U.S. 593, 601-03 (1972).

99. *See supra* notes 73-97 and accompanying text.

100. *See* Spiegelman v. Comm'r, 102 T.C. 394, 403 (1994) (stating not all amounts of employment income under the general definition of wages provided in I.R.C. § 61 are wages) (citing Cent. Ill. Pub. Serv. Co. v. United States, 435 U.S. 21, 25 (1978)).

101. Rev. Rul. 58-301, 1958-2 C.B. 23 (2004); Milligan v. Comm'r, 38 F.3d 1094 (9th Cir. 1994); Gump v. United States, 86 F.3d 1126 (Fed. Cir. 1996).

102. In Revenue Ruling 58-301, 1958-1 C.B. 23, the Internal Revenue Service was requested to determine "whether an amount received by an employee as consideration for the cancellation of an employment contract constitutes ordinary income or capital gain, and, in either event, the taxable year of its inclusion gross income." Rev. Rul. 58-301, 1958-1 C.B. 23. The Internal Revenue Service answers inquiries from individuals and organizations "whenever appropriate in the interest of sound tax administration" to provide guidance regarding the tax effects of particular transactions and/or to provide guidance regarding a taxpayer's status for tax purposes. 26 C.F.R. § 601.201(a) (2004). The Internal Revenue Service provides official interpretations and application of tax laws to specific facts and circumstances through Revenue Rulings. *Id.* § 601.201(a)(6). While Revenue Rulings provide guidance on substantive tax matters, they do not have the force and effect of a regulation because no notice or opportunity has been given to the public. 5 U.S.C. §§ 553(b)-(d) (2004).

103. Rev. Rul. 58-301, 1958-1 C.B. 23.

104. *Id.*

105. *Id.* Specifically, Revenue Ruling 58-301 provides the following:

> Accordingly, it is held that a lump sum payment received by an employee as consideration for the cancellation of his employment contract constitutes gross income to the recipient in the taxable year of receipt. However, such amount is not subject to

301 relied upon *McFall v. Commissioner*,[106] which held that such a contract constituted a property right.[107] Accordingly, the Service ruled that while a contract right was not a capital asset, it nevertheless did not constitute wages for purposes of income or FICA withholding.[108]

A 1994 decision of the Ninth Circuit Court of Appeals also provides guidance on whether or not the purchase of an employment contract constitutes wages for purposes of income of FICA withholding.[109] Milligan was an insurance agent working for State Farm Insurance Company.[110] Milligan had entered into a number of employment contracts, the last of which provided for certain termination payments in the event that he separated from service.[111] To qualify for termination payments, it was necessary for Milligan to have worked for at least two years with State Farm, sold policies, and agreed not to compete with State Farm following his termination.[112] The amount of his termination payments was determined by

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Federal employment and income tax withholding provisions of Section 3121 of the Federal Insurance Contributions Act in Section 3402 of the Code, (Chapters 21 and 24, respectively, Subtitle C, Internal Revenue Code of 1954). *See* Rev. Rul. 55-520 C.B. 1955-2, 393.

Id.

106. 34 B.T.A. 108 (1936).

107. *McFall*, 34 B.T.A. at 110-11. The *McFall* decision involved the determination of whether the sale and assignment of an employment contract to a third person resulted in capital gain. *Id.* In *McFall*, the United States Board of Tax Appeals held that the sale of an employment contract to a third person did not result in a capital gain. *Id.* In *McFall*, the United States Board of Tax Appeals stated the following:

> [T]here was a right of petitioners to continue to perform service and then to be paid-to persist in their contractual relation for its agreed term. While this right is property in the constitutional sense, in that it could not be arbitrarily legislated away, it is not capital . . . . Obviously it is not the sort of property which is susceptible of ownership for a length of time as is a share of stock, a bond, or a thing.

Id.

The United States Board of Tax Appeals also reached a similar conclusion in George K. Gann v. Commissioner. 41 BTA 388 (1940). In *Gann*, the United States Board of Tax Appeals held that payment from an employer to an employee for the cancellation of a contract of employment was ordinary income and not capital gain. *Id.* However, Revenue Ruling 58-301 noted that the *Gann* decision was premised upon the distinction that the employee had special qualifications and skills that were a material and greeting of the contract and therefore the contract could not be sold. Rev. Rul. 58-301, 1958-2 C.B. 23.

108. Rev. Rul. 58-301, 1958-2 C.B. 23.

109. *See* Milligan v. Comm'r, 38 F.3d 1094 (9th Cir. 1994) (reversing the underlying Tax Court decision, Milligan v. Comm'r, 64 T.C.M. (CCH) 1282 (1992)). The IRS subsequently issued a notice of nonacquiescence to the Ninth Circuit's decision in *Milligan*. Milligan v. Comm'r, 1996-1 I.R.B. 5. The Tax Court, subsequent to the Ninth Circuit opinion, expressly overruled its earlier decision in *Milligan* after concluding that the Ninth Circuit's decision and rationale were persuasive. Jackson v. Comm'r, 108 T.C. 130, 137 (1997).

110. *Milligan*, 38 F.3d at 1095.

111. *Id.*

112. *Id.* at 1095-97.

a fraction of the amount of his prior compensation.[113] Milligan's contract of employment provided for a *right* to be bought out, a factor which is not present with respect to the tenured university faculty members and certainly provides greater weight for the position that tenure purchases are not wages; a tenured faculty member *might* be bought out of tenure by the university but the faculty member has no *right* to be bought out.[114]

While the Tax Court felt that the payments were subject to self-employment tax, the Ninth Circuit reversed.[115] The Ninth Circuit held, "to be taxable as self-employment income, earnings must be tied to the quantity or quality of the taxpayer's prior labor, rather than the mere fact that the taxpayer worked or works for the payer."[116]

In *Milligan*, the Government argued that Milligan's previous status of working for State Farm provided the only necessary link for subjecting the payments to withholding taxes.[117] The Ninth Circuit responded by holding:

> Without more, this link between the disputed payments and any business activity carried on by Milligan does not satisfy the "derive" requirement. It is not enough that, had the taxpayer not performed certain services (that were fully compensated for)—not been an independent contractor, for example—the taxpayer never would have received the disputed payments. *See Newberry* [*v. Commissioner*,] 76 T.C. [441,] 445 [1981] (harmonizing self-employment tax with the Federal Unemployment Tax Act and the Federal Insurance Contributions Act: [Footnote 7 omitted] *An individual who becomes eligible for benefits as a 'result of the individual's employ[ment] status at some previous time' has not received wages subject to social security tax. "[I]n no way are the benefits a function of the employee's providing services for his*

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113. *Id.* at 1096.

114. *Id.*

115. *Id.* at 1095. *See* Milligan v. Comm'r, 64 T.C.M. (CCH) 1282, 17 (1992) (focusing on the fact that the termination payments made to Milligan, although not based upon renewal commissions, were based upon the policies enforced in the last year of the agency). The Tax Court therefore concluded that the termination payments were the equivalent of deferred compensation received by the agent for policies sold in prior years. *Id.* After concluding that the termination payments were the equivalent of deferred compensation, the Tax Court held that the payments were "derived from self-employment, even though they are received in years subsequent to the activity which generated them. Consequently, we hold that [t]ermination [p]ayments constitute income from self-employment and are subject to self-employment tax." *Id.* at 19.

116. Milligan v. Comm'r, 38 F.3d 1094, 1098 (9th Cir. 1994). Self-employment income is (1) derived (2) from a trade or business (3) carried on by an individual. *Id.* at 1097.

117. *Id.* at 1098. The dispute in *Milligan* was whether the income was "derived" from Milligan's trade or business. *Id.* The Ninth Circuit focused on the term "derived" and the required nexus between the income and the trade or business. *Id.*

> *employer. Those benefits are not derived from any employment carried on.*").
>
> Because Milligan had been fully compensated for his services none of his business activity was the "source" of the Termination Payments. The payments did not represent deferred compensation of previously-earned commissions. . . .[118]

The Ninth Circuit held that the payments were not derived from Milligan's prior service for which he had been fully compensated.[119] Therefore, the payments could not be "wages" subject to the duty to withhold.[120]

The United States Court of Appeals for the Federal Circuit has also decided a case involving the purchase of future employment.[121] Like Milligan, Gump was an insurance agent who received payment pursuant a business cancellation agreement.[122] The Federal Circuit recognized that Gump's payment did not derive from withheld portions of his prior salary.[123] The Federal Circuit recognized that Gump had no vested right to receive payments and the payments were conditional upon two contractual requirements.[124] While the payments were computed by reference to prior earnings, the reference was a reasonable indicator of the value of the right being relinquished by Gump.[125]

The Federal Circuit placed no significance on the fact that the calculation of the payment for termination of Gump's property right was tied to Gump's past earnings.[126] The Federal Circuit noted the following:

> [T]he renewal commissions generated in Gump's last year determined the amount of the extended earnings payment, subject to adjustment, not the right to it. The only significance that can properly be attached to this amount is that it was used as a benchmark to determine how much he would receive if he complied with the agreement.[127]

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118. *Id.* at 1098-99 (emphasis added).
119. *Id.* at 1099.
120. *Id.*
121. Gump v. United States, 86 F.3d 1126 (Fed. Cir. 1996).
122. *Id.* at 1127.
123. *Id.* at 1128.
124. *Id.* at 1129.
125. *Id.* at 1129-30. The prior year's earnings were only a "benchmark" for calculation and Gump was not entitled to the prior year's earnings. *Id.*
126. *Id.*
127. *Id.* at 1129.

As with the *Gump* and *Milligan* decisions, the tenured faculty members at NDSU received a payment based upon a percentage of their prior salary.[128] The percentage of the prior salary is used only for convenience as a way of valuing the property interest that is being terminated.[129] Payments ranged from 100% to 25% of the faculty member's last year's salary.[130]

Tenure possesses unique and intangible qualities.[131] As noted by the United States District Court for the District of North Dakota with regard to defining tenure:

> Tenure is an ethereal concept; although commonly understood, tenure escapes precise definition. To add to its abstract nature, tenure only truly exists in a small, albeit important niche of the world, namely on college and university campuses. Yet in this niche, tenure is an extremely valuable achievement.[132] The value of tenure as a property interest cannot be disputed.[133]

It is clear that the unique nature of tenure has less to do with the quality or quantity of the faculty member's labor, but instead exists for the purpose of ensuring academic freedom that is fundamental to the advancement of

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128. N.D. State Univ. v. United States, 84 F. Supp. 2d 1043, 1045 (D.N.D. 1999).

129. *Id.* at 1045. It is possible for a retiring faculty member to receive a payment equal to 100% of his or her final year's salary. *Id.* A number of factors, including past performance, current salary, curriculum needs of the university, and the available budget are all considered in determining the amount to be paid to purchase the tenure rights. *Id.*

130. *Id.* at n.4.

131. *Id.* at 1050.

132. *Id.* The United States District Court for the District of North Dakota also noted that the policy manuals for NDSU and the North Dakota Board of Higher Education noted the following regarding tenure: "A college or university is a forum for ideas, and it cannot fulfill its purpose of transmitting, evaluating, and extending knowledge if it requires conformity with any orthodoxy of content and method. Academic freedom and tenure are both important in guaranteeing the existence of such a forum." N.D. STATE UNIV. POLICY MANUAL § 350.1(1); N.D. STATE BD. OF HIGHER EDUC. POLICY MANUAL § 605.1(1)(a). In noting that academic freedom applies to all scholarly pursuits and is fundamental to the achievement of knowledge, the United States District Court for the District of North Dakota quoted the following from the United States Supreme Court:

> The essentiality of freedom in the community of American universities is almost self-evident. No one should underestimate the vital role in a democracy that is played by those who guide and train our youth. To impose any straight jacket upon the intellectual leaders in our colleges and universities would imperil the future of our Nation. No field of education is so thoroughly comprehended by man that new discoveries cannot be made. Particularly is that true in the social sciences, where few, if any, principles are accepted as absolutes. Scholarship cannot flourish in an atmosphere of suspicion and distrust. Teachers and students must always remain free to inquire, to study and evaluate, to gain new maturity and understanding; otherwise our civilization would stagnate and die.

N.D. State Univ., 84 F. Supp. 2d at 1050 (quoting Sweezy v. State of New Hampshire, 354 U.S. 234, 250 (1957)).

133. *Id.* at 1051.

knowledge.[134] It is this unique nature that makes the purchase of a tenure property interest fall outside the scope of providing compensation for the prior work of the faculty member.

C. CONCLUSION: TENURE IS A PROTECTED PROPERTY INTEREST, THE PURCHASE OF WHICH IS NOT THE PAYMENT OF WAGES

Tenured faculty members have a constitutionally protected property right, which when purchased does not constitute compensation for purposes of FICA taxation. Both federal and state substantive laws clearly establish that tenured faculty members have a property interest. Under the reasoning employed by the Ninth Circuit in the *Milligan* decision, the payments are not derived from the tenured faculty member's prior service; service for which they have been fully compensated. This is consistent with Revenue Ruling 58-301, 1958-2 C.B. 23 and the *Gump* decision. This legal foundation compels the conclusion that the purchase of tenure is the purchase of a property interest, which is not subject to FICA taxation.

V. CASE LAW, WHICH HAS DEVELOPED IN SELF-EMPLOYMENT TAX CASES, PROVIDES GUIDANCE FOR THE RESOLUTION OF WHETHER TENURE FALLS WITHIN THE DEFINITION OF "WAGES"

A. SELF-EMPLOYMENT TAX IS EQUIVALENT TO FICA

The United States Tax Court has previously recognized the close relationship between the self-employment tax and taxation under the Federal Insurance Contribution Act.[135] In *Spiegelman*, the Tax Court stated the following:

> Chapter 21, commonly referred to as the Federal Insurance Contributions Act (FICA) (secs. 3101-3128), and chapter 23, commonly known as the Federal Unemployment Tax Act (FUTA) (secs. 3301-3311), impose certain taxes on employers and employees based on wages paid to employees. *For self-employed individuals, roughly corresponding taxes are imposed on self-employment income derived from carrying on a trade or business.* Ch. 2 (secs. 1401-1403); *see Newberry v. Commissioner*, 76 T.C.

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134. *Id.* at 1050.

135. Spiegelman v. Comm'r, 102 T.C. 394 (1994). *See also* Milligan v. Comm'r, 38 F.3d 1094, 1099 n.7 (9th Cir. 1994) (stating "the self-employment tax on self-employed individuals is the counterpart to the tax on employees' wages under the Federal Unemployment Tax Act ('FUTA') and the Federal Insurance Contribution Act (FICA)").

441, 443 (1981). In the case of FICA and FUTA taxes, not all amounts of income under section 61 received from an employer are includable in the definition of wages. *Central Ill. Pub. Serv. Co. v. United States*, 435 U.S. 21, 25 (1978). [Footnote 7 omitted] And, with regard to tax on self-employment income, not all amounts of income received are derived from carrying on a trade or business. *Newberry v. Commissioner*, *supra*.[136]

Because of the close relationship between self-employment tax and the tax imposed on employees pursuant to the Federal Unemployment Tax Act and the Federal Insurance Contribution Act, the cases involving self-employed individuals with property rights in their relationships are helpful in determining whether the purchase of a property interest is subject to FICA taxation. This is particularly true in tenure cases where the Government concedes that prior to the *NDSU* decision, no direct court or administrative precedent existed for determination of this issue.[137]

B. THE DEFINITION OF "WAGES" IS DEFINED MUCH MORE NARROWLY THAN INCOME IN THE CONTEXT OF WITHHOLDING TAXES

The duty to withhold FICA taxes is construed very broadly.[138] There is no question that the broad scope of the term "wages" was intended by

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136. *Spiegelman*, 102 T.C. at 403 (emphasis added). Spiegelman held a Bachelor's Degree of Arts in Geology and Geophysics from Harvard University and a Ph.D. from the University of Cambridge in England. *Id.* at 395. Spiegelman was awarded a one-year Lamont Post-Doctoral Research Fellowship from Columbia University in the amount of $27,500. *Id.* Despite its label as "non-employee compensation," the Tax Court determined that the fellowship grant was not subject to self-employment taxation because it was not paid as compensation to Spiegelman for services. *Id.* at 406. The Tax Court determined that the fellowship award was not income derived from a trade or business but was instead a "noncompensatory scholarship and fellowship grant more from the 'detached and disinterested' munificence of the grantor than from the activities of the recipient in carrying on a trade or business." *Id.*

137. *But see* Slotta v. Tex. A & M Univ. Sys., No. G-93-92, 1994 U.S. Dist. LEXIS 21205 (S.D. Tex. Aug. 10, 1994) (unpublished decision).

138. United States v. Silk, 331 U.S. 704, 711 (1947); Halvering v. Davis, 301 U.S. 619, 641 (1937). The Internal Revenue Code defines "wages" as "all remuneration from employment," unless the remuneration falls within one of the statutorily specified exceptions. I.R.C. § 3121(a) (2004). Similarly, the term "employment" is defined broadly as "any service, of whatever nature, performed . . . by an employee for the person employing him." *Id.* § 3121(b). These broad definitions have been interpreted to be consistent with the purpose of FICA in "protecting beneficiaries from some of the hardships of existence" by providing broad definitions that will capture an expansive range of remuneration. *Silk*, 331 U.S. at 711. The definitions of "wages" and "employment" used to impose FICA taxation originated in the Social Security Act of 1935 and have since that time remained relatively unchanged. Social Security Act of 1935, Pub. L. No. 74-271, § 210, 49 Stat. 620, 625 (1935). The Congressional intent in developing the FICA taxation system has been summarized as intended to apply to a broad range of employer-furnished remuneration in order to accomplish the remedial purposes of the Social Security Act. *See* H.R.

Congress to provide that all payments arising out of the employer-employee relationship would be subject to FICA taxation.[139] Despite the broad definition intended for the term "wages," no authority stood for the proposition that FICA statutes are to be interpreted broadly and involve a factual situation where a property interest has been terminated. However, substantial authority exists to establish that the definition of wages is to be narrowly construed under such circumstances.[140] "Indeed, 'wages,' in the withholding context, is defined more narrowly than income."[141] Even though a payment may constitute income to an employee it does not necessarily follow that the payment will be deemed "wages" subject to withholding provisions.[142]

In order for there to be a duty to withhold, there must be a relationship between the payment and the performance of services.[143] That relationship

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REP. NO. 74-615, 1st Sess. 3 (1935), *reprinted in* 1939-2 C.B. 600, 601 (describing purpose of Social Security Act); *Silk*, 331 U.S. at 712; *Davis*, 301 U.S. at 641.

139. *See* Lane Processing Trust v. United States, 25 F.3d 662, 665 (8th Cir. 1994) (construing the terms "wages" and "employment" broadly in order to accomplish the remedial purposes of FICA taxation and FUTA taxation). The legislative history for the Social Security Act Amendments of 1983, Pub.L. No. 98-21, 97 Stat. 65 provide further confirmation of the broad definition to be applied to the term "wages." S. REP. NO. 98-23, 98th Cong. 1st Sess. at 42, *reprinted in* 1983-2 C.B. 326, 333; H.R. REP. NO. 98-25, P.T. 1 at 80, *reprinted in* 1983 U.S.C.C.A.N. 219, 299.

140. Gen. Elevator Corp. v. United States, 20 Cl. Ct. 345, 351 (Cl. Ct. 1990) (citing Cent. Ill. Pub. Serv. Co. v. United States, 435 U.S. 21, 29 (1978); Hotel Conquistador, Inc. v. United States, 597 F.2d 1348, 1353-54 (Ct. Cl. 1979)). In *General Elevator*, the employees received per diem payments and other reimbursement for out-of-pocket expenses when they traveled to various job sites. *Id.* at 352. The Court of Claims was charged with determining whether the per diem payments to the employees of General Elevator were "wages." *Id.* The Court of Claims, applying the definition of wages as used in § 3401(a) and clarified in Treas. Reg. § 31.3401(a)-1(b)(2) excluded reimbursements for travel or other bona fide ordinary necessary expenses paid by an employee but reasonably expected to be incurred in the business of the employer. *Id.*

141. *Id.* at 351. As noted by the United States Claims Court, "even though certain payments of expenses to an employee may constitute income to the employee, it does not necessarily follow that they will be deemed 'wages' subject to the withholding provision." *Id.*; *see also Hotel Conquistador, Inc.*, 597 F.2d at 1353-54 (defining the term "wages" more narrowly than income in the withholding context).

142. *Gen. Elevator Corp*, 20 Cl. Ct. at 352.

143. *Id.* at 351 (citing Humble Oil & Refining Co. v. United States, 442 F.2d 1362 (Ct. Cl. 1971)). Not all payments made to an employee by an employer are wages under § 3401(a). Stubbs, Overbeck & Assoc. v. United States, 445 F.2d 1142, 1149 (Ct. Cl. 1971). Payments must be made "for services performed" in order to be considered wages. *Id.* The determination of what constitutes wages for withholding purposes is a separate and distinct question from determining whether a payment is an economic gain to the employee that must be included within the employee's taxable income. *Id.*

> Whether or not payments are taxable to, or deductible by, the employee is immaterial with regard to whether they are subject to withholding by the employer. That is a matter between the employee and government. An employee may receive economic benefits from his employer that are not subject to the withholding provisions of the Code.

Id.

must also be viewed from the standpoint of the employer's purpose in making the payment.[144]

C. THE PURCHASE OF A CONTRACT RIGHT FROM A SELF-EMPLOYED INDIVIDUAL IS ANALOGOUS TO THE PURCHASE OF TENURE

Imposition of self-employment tax closely resembles the tax that is imposed under FICA.[145] For purposes of determining whether there is a duty to withhold, the term "wages" is defined much more narrowly than the term income.[146] In order to impose a duty to withhold on an institution's payment to purchase tenure rights, the payment must be determined to have been made for the performance of services.[147] The purchase of tenure does *not* constitute payment for the performance of service because, from the standpoint of the institution, the purchase of tenure is the purchase of a property interest unrelated to compensation for prior services.

It is clear under both state and federal law that tenure is a property interest.[148] A tenured faculty member's property interest cannot be terminated without adequate cause or due process.[149] The tenure property interest has value separate and apart from the services which are being provided by the faculty members.[150]

The decisions in *Milligan* and *Gump* establish that when an employer is providing payment for the purpose of terminating a contractual relationship those payments do not constitute wages for purposes of FICA withholding.[151] In an attempt to terminate the tenured faculty member's property interest without the necessity of due process and/or the existence

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144. *Humble Oil & Refining Co.*, 442 F.2d at 1367. Because the employer is the taxpayer "it is the purpose of the employer that controls in determining whether payments are remuneration under § 3401(a) for services performed." *Id.*

145. *See supra* notes 135-137 and accompanying text.

146. *Gen. Elevator Corp.*, 20 Cl. Ct. at 351.

147. Cent. Ill. Pub. Serv. Co. v. United States, 435 U.S. 21, 27 (1978). As noted by the United States Supreme Court in *Central Illinois Public Service Co.*, "the committee reports of the time stated consistently that 'wages' meant remuneration 'if paid for services performed by an employee for his employer.'" *Id.* (quoting H.R. REP. NO. 77-2333, 2nd Sess., at 126 (1942); S. REP. NO. 77-1631, 2nd Sess., at 166 (1942); H.R. REP. NO. 78-401, 1st Sess., at 22 (1943); S. Rep. No. 78-221, 1st Sess., at 17 (1943); H.R. Rep. No. 78-510, 1st Sess., at 29 (1943)). The Supreme Court also specifically noted that "it is one thing to say that the reimbursements constitute income to the employees for income tax purposes, and it is quite another thing to say that it follows therefrom that the reimbursements in 1963 were subject to withholding." *Id.* at 29. "There is a gap between the premise and the conclusion and it is a wide one." *Id.* The Supreme Court further noted that the requirement of withholding "is rightly much narrower than subjectability to income taxation." *Id.*

148. *See supra* notes 73-95 and the accompanying text.

149. Morris v. Clifford, 903 F.2d 574, 577 (8th Cir. 1990).

150. N.D. State Univ. v. United States, 84 F. Supp. 2d 1043, 1051 (D.N.D. 1999).

151. *See supra* notes 109-30 and accompanying text.

of adequate cause, an institution may find it desirable to make a payment to the faculty member to purchase the faculty member's tenure. The payment to the faculty member is not being provided for the remuneration of past services but instead to terminate a legitimate property interest.

The mere fact that the amount of compensation that is provided to the tenured faculty member is based upon a past salary is not sufficient to transform the property interest into a remuneration for services. Similar circumstances existed in *Milligan* and *Gump*. Reference to past services is used as a benchmark to determine how much a tenured faculty member will receive when and if they comply with the terms of the retirement agreement.[152]

D. THE CASE LAW UPON WHICH THE GOVERNMENT RELIED IS DISTINGUISHABLE FROM THE PURCHASE OF TENURE

To support its position in *NDSU*, the Government primarily relied upon three decisions: *Lane Processing Trust v. United States*,[153] *Mayberry v. United States*,[154] and *Associated Electric Coop., Inc. v. United States*.[155] None of these decisions related to the purchase of a property interest.

In *Lane*, the taxpayer did not raise the issue of whether or not a property interest was being purchased.[156] In *Lane*, the taxpayer argued the following: (1) that because the employees were owners, the payments made to the employees were dividends and not wages; (2) that the employees were not employees of the taxpayer; and (3) that the payments were not bargained for.[157] The *Lane* case did not raise the issue of whether or not the purchase of a property interest constitutes remuneration for services.

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152. *See, e.g.*, Gump v. United States, 86 F.3d 1126, 1129 (Fed. Cir. 1996). In *Gump*, the Court of Appeals for the Federal Circuit determined that the taxpayer's right to receive the payments arose from the cancellation of the relationship between Gump as an insurance agent for Nationwide Insurance. *Id.* at 1128. Similarly, in *Milligan*, the Ninth Circuit also determined that payments derived from the termination of a taxpayer's business are not subject to self-employment tax. Milligan v. Comm'r, 38 F.3d 1094, 1098 n.6 (9th Cir. 1994). As noted by the Court of Appeals for the Federal Circuit, the payments arose from cancellation of the agreement and, absent cancellation of the agreement, no right to the payments existed. *Gump*, 86 F.3d at 1128.

153. 25 F.3d 662 (8th Cir. 1994).

154. 151 F.3d 855 (8th Cir. 1998).

155. 42 Fed. Cl. 867 (Fed. Cl. 1999).

156. *Lane Processing Trust*, 25 F.3d at 662. In order to avoid liquidation, several companies created a trust that ultimately made payments to the company's former employees after the companies were sold. *Id.* at 663. The taxpayers asserted that distributions by the trust to former company employees were not subject to FICA or FUTA taxation. *Id.* at 666. The Eighth Circuit Court of Appeals held that distributions to the former employees constituted "wages" and therefore were subject to FICA and FUTA taxation. *Id.*

157. *Id.* at 665-66.

In *Lane*, the employees accepted lower wages and benefits with knowledge that a trust had been established for their benefit, which would be distributed once the company was profitable.[158] At one point the company "distributed a letter to the employees, informing them of recent events and telling them that their efforts had played an integral role in the Companies' turnaround and that the cash from the sale [of the trust] belonged to them."[159] In *Lane*, the employees at-will received additional compensation which had been set aside to encourage continued employment.[160] This is significantly different from payments to terminate a property interest.

The *Mayberry* decision resulted from employment tax litigation, which arose out of the "Continental Can settlement."[161] Several Circuit Courts split on the issue of whether or not the payments from the "Continental Can settlement" were subject to employment taxation.[162] In *Dotson v. United States*,[163] the Fifth Circuit determined that the "Continental Can settlement" awards were not subject to FICA taxation and were not wages because the awards constituted payment on account of personal injuries or sickness excluded and therefore were excluded from the taxpayer's income.[164] Given the split of authority, the *Mayberry* decision has very little persuasive value.

The *Mayberry* decision is also factually distinguishable from the purchase of tenure. The *Mayberry* decision did not raise the issue of whether or not payment for voluntary termination of a property interest is wages.

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158. *Id.* at 664.

159. *Id.*

160. *Id.* As noted by the Eighth Circuit, "the payments made to each employee were based on factors traditionally used to determine the employee compensation, specifically, the value of the services performed by the employee, the length of the employee's employment, and the employee's prior wages." *Id.* at 665.

161. Mayberry v. United States, 151 F.3d 855, 857 (8th Cir. 1998). The "Continental Can settlement" cases involve consolidated class action suits that had been initiated by 5,000 former employees of Continental Can Company asserting that the company had interfered with the attainment of pension rights by employees in violation of Section 510 of ERISA. *Id.* A settlement fund was established to provide distribution to class members. *Id.* Pursuant to an agreement between the parties, the payments made to class members were subject to withholding and the individual class members thereafter initiated refund claims seeking a recovery of the employment taxes paid on the award. *Id.* The taxpayers asserted that the award was neither taxable as income nor wages pursuant to I.R.C. § 104(a)(2), which excludes from income "damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness." *Id.*

162. *See, e.g.*, Dotson v. United States, 87 F.3d 682, 686-88 (5th Cir. 1996) (determining, by a split panel, that the payments were excluded from the taxpayer's income); Helmut v. United States, 122 F.3d 204 (4th Cir. 1997) (determining that because relief under the ERISA provisions is equitable in nature, the award was taxable).

163. 87 F.3d 682 (5th Cir. 1996).

164. *Dotson*, 87 F.3d at 686-88.

The *Mayberry* decision discussed the issue of whether the payments were personal injury damages excluded from FICA taxation.[165] The Eighth Circuit concluded that the payments to the employees were not personal injury damages excluded from FICA taxation.[166]

A third case relied upon by the Government to support its position that the payment of tenure constitutes "wages" was *Associated Electric Coop., Inc. v. United States*.[167] In *Associated Electric Coop.*, all of the employees were eligible to be provided with voluntary "early out" payments.[168] In contrast, institutions initiating tenure buyouts provide payments only to people with existing property interests. Employees who do not have a protected property interest are not provided with buyouts.

Although *Associated Electric Coop.* involved termination of an agreement with the United Mine Workers Association, the Federal Court of Claims specifically found that buyout was also offered to non-union employees and that the right to strike was never at issue because the termination of the employees occurred prior to the date the union employees would have had a right to strike.[169] In other words, the Federal Court of Claims in *Associated Electric Coop.* concluded that no property interest existed and therefore the payments were subject to FICA taxation.[170]

VI. THE ALTERNATIVE DEPUTY TAXPAYER DEFENSE HAS BEEN ELIMINATED

A. THE DEPUTY TAXPAYER CONCEPT REQUIRES AN EMPLOYER TO HAVE CLEAR AND PRECISE NOTICE OF DUTY TO WITHHOLD

An employer may be relieved from its obligation to withhold FICA taxes if the employer is not given clear and precise notice of a duty to

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165. *Mayberry*, 151 F.3d at 857.

166. *Id.* at 858-61. The Eighth Circuit relied upon United States Supreme Court precedent establishing that the personal injury damages are not contemplated under the provisions of ERISA, and therefore the taxpayer's assertion that the award represented compensation for personal injury excluded from income under § 104(a)(2) was erroneous. *Id.* at 859.

167. 42 Fed. Cl. 867 (Fed. Cl. 1999).

168. *Associated Electric Coop.*, 42 Fed. Cl. at 870-71, 877.

169. *Id.* at 871-72, 877.

170. *Id.* at 877. The Federal Court of Claims distinguished Revenue Ruling 74-252, 1974-1 C.B. 287, which held payments that were in the nature of a property interest were not subject to FICA taxation. *Id.* Although the purchase of "the right to strike" may be in the nature of a property interest, with respect to the employees in *Associated Electric Coop.* the right to strike was never at issue because the termination occurred prior to the date the right to strike would have vested. *Id.*

withhold.[171] In *Central Illinois Public Service Co. v. United States*,[172] the United States Supreme Court recognized that each employer is a "deputy tax collector" with respect to withholding of FICA and income taxes.[173] Because the employer is usually not able to recover any of the taxes that are retroactively imposed, the United States Supreme Court has held that each employer is entitled to clear and precise notice that there is a duty to withhold.[174] Accordingly, even though an employer might have a duty to withhold, the IRS is not permitted to assess delinquent taxes unless the employer had "clear and precise" notice of a duty to withhold.[175]

The Application of the "Deputy Tax Collector" Doctrine has been described by the United States Claims Court.[176] In *General Elevator Corp.*,[177] an employer provided an allowance for travel expenses to workers when they traveled beyond a certain distance from their home office.[178] The United States Claims Court determined that the nature of the payments was not directly related to the reimbursement of expenses and accordingly constituted wages for the purposes of withholding and the FICA tax.[179] However, the United States Claims Court held that the taxpayer was entitled to relief. The Court of Claims determined that without "clear and precise" notice that there is a duty to withhold, no employer could reasonably expect that a withholding obligation existed.[180]

B. NDSU RECEIVED ADVICE FROM THE SSA THAT THE PURCHASE OF TENURE DID NOT REQUIRE WITHHOLDING

In its attempt to determine whether or not it had a duty to withhold NDSU consulted with the SSA and the IRS.[181] In early 1991, NDSU researched the possible need for FICA withholding on the tenure buy-outs being initiated by NDSU.[182] NDSU took the initiative to determine the

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171. Gen. Elevator Corp. v. United States, 20 Cl. Ct. 345, 352 (Cl. Ct. 1990).

172. 435 U.S. 21 (1978).

173. *Cent. Ill. Pub. Serv. Co.*, 435 U.S. at 31.

174. *Id.* An employer's obligation to withhold must be precisely defined and not speculative. *Id.*

175. *Gen. Elevator Corp.*, 20 Cl. Ct. at 532.

176. *Id.* at 535.

177. 20 Cl. Ct. 345 (Cl. Ct. 1990).

178. *Gen. Elevator Corp.*, 20 Cl. Ct. at 347.

179. *Id.* at 354.

180. *Id.* at 353-54. After reviewing the pertinent revenue rulings, the Court of Claims summarized that the rulings "leave a speculative gap where plaintiff, when faced with ambiguous or inapplicable interpretations, cannot reasonably be held to have received a degree of notice the law requires." *Id.* at 354.

181. N.D. State Univ. v. United States, 84 F. Supp. 2d 1043, 1046 (D.N.D. 1999).

182. *Id.*

status of those payments by visiting with the IRS office in Fargo.[183] The IRS did not provide an answer to NDSU's question.[184]

NDSU then initiated contact with the SSA personnel in Fargo, North Dakota, and presented them with the same issue it had presented to the IRS.[185] NDSU carefully explained the nature of faculty tenure and was told that the SSA agent would consult with higher and more knowledgeable SSA personnel and return with an answer. The SSA subsequently advised NDSU in writing that payments to secure the release of the unexpired contract of employment are not considered wages.[186] The letter from the SSA provided that "according to its operations manual 'a payment to secure the release of an unexpired contract of employment is not considered wages.'"[187] What this means is that the payment is not considered in determining benefit amounts, nor is it used for deduction of benefit purposes. This type of payment would have no effect on an individual's social security eligibility or their entitlement.

The letter made reference to SSA's Program Administration Manual. That regulation provides the following: "The purchase of contract payments is payments to secure the release of an unexpired contract of employment, either by an agreement between the employee and the employer, or as the result of a judgment. These payments are not in remuneration for employment."[188]

Despite NDSU's assertion of the "Deputy Tax Collector" defense, the district court determined that it was not applicable to NDSU.[189] The district court noted that prior to 1991, NDSU had withheld FICA taxes from early retirement payments.[190] NDSU did not begin to question the withholding practice until several prospective retirees began to question the practice and NDSU thereafter initiated research to change its position.[191] The "Deputy Tax Collector" defense only applies to the employer's portion of the FICA tax.[192]

In *NDSU*, the "Deputy Tax Collector" defense only applied to payments made to administrators and not to payments made to tenured faculty

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183. *Id.*
184. *Id.* 1046-47.
185. *Id.* at 1047.
186. *Id.*
187. *Id.*
188. SOCIAL SECURITY ADMINISTRATION, PROGRAM OPERATIONS MANUAL, RS 01401.430.
189. N.D. State Univ. v. United States, 84 F. Supp. 2d 1043, 1050 (D.N.D. 1999).
190. *Id.* at 1049-50.
191. *Id.* at 1050.
192. H.B. & R, Inc. v. United States, 229 F.3d 688, 692 (8th Cir. 2000).

members because the court had already determined that the tenured faculty members were relinquishing the property interest.[193] The Eighth Circuit distinguished administrators from tenured faculty members and noted that there was no basis for NDSU to stop withholding payments from administrators.[194] The Eighth Circuit further noted that the information requested from the SSA was directed toward the tenure buy-out program and did not include a request regarding the administrators who also participated in the program.[195] The Eighth Circuit concluded that the notice to withhold with respect to administrators was clear in 1991.[196]

VII. THE EIGHTH CIRCUIT CONFIRMED THAT PAYMENTS MADE TO PURCHASE TENURE ARE NOT "WAGES" SUBJECT TO FICA TAXATION

The Eighth Circuit initiated a review of the United States District Court for the District of North Dakota's decision determining that early retirement payments made to tenured faculty members were not wages.[197] The Eighth Circuit acknowledged that the term "wages" and the term "employment" are broadly defined within the context of FICA taxation.[198] However, the Eighth Circuit also noted that not all payments that are made by employers to employees constitute wages and that many items which qualify as income to an employee are clearly not within the definition of wages.[199] The Eighth Circuit summarized that although wages and employment are to be read broadly in the context of FICA taxation, "the payments must be remuneration for services provided by the employee to his employer to be subject to FICA taxes."[200]

The Eighth Circuit noted that the Internal Revenue Service itself has recognized that payments made to terminate rights under a contract are not wages for FICA taxation purposes.[201] Payments made to terminate a

193. N.D. State Univ. v. United States, 255 F.3d 599, 608-09 (8th Cir. 2001).
194. *Id.* at 609.
195. *Id.*
196. *Id.*
197. *Id.* at 599.
198. *Id.* at 603.
199. *Id.*
200. *Id.*
201. *Id.* at 604. The Eighth Circuit noted that the IRS has previously indicated payments to relinquish rights under a contract are not "wages" for FICA purposes. *Id.* (citing Rev. Rul. 58-301, 1958-1 C.B. 23, 1958 W.L. 10630) (2004)). As noted by the Eighth Circuit, the only federal district court case that appears to have ever addressed the issue of whether FICA taxes applied to payments to tenured faculty for release of their tenure rights is an unpublished decision from the Southern District of Texas. *Id.* at n.5 (citing Slotta v. Tex. A & M Univ. Sys., No. G-93-92, 1994 U.S. Dist. LEXIS 21205 (S.D. Tex. Aug. 10, 1994)).

contract need to be distinguished from payments made pursuant to an employment contract as payments for past services and payments for seniority rights, which are all treated as wages for FICA purposes by the Internal Revenue Service.[202] The Eighth Circuit therefore characterized the determinative issue as "whether the payments made under NDSU's Early Retirement Program to tenured faculty in exchange for release of the faculty's tenure rights are payments to relinquish contractual or property rights, payments pursuant to a contractual agreement, payments for past services, or something else."[203]

In the *NDSU* decision, both parties agreed that tenure was a protected property right.[204] The Eighth Circuit acknowledged tenured faculty members have not only a constitutional right to procedural due process rights to be free but also have substantive due process rights that prevent the arbitrary and capricious discharge of the faculty member.[205]

The Eighth Circuit noted that although tenure cannot be bought and sold at an open market, it nonetheless has economic value.[206] Despite the lack of market, tenure has significant value to the faculty member to whom tenure has been granted.[207] Additionally, tenure is a relationship that develops gradually, and transforms the "at will relationship" between the university and the faculty member into a subsequent "tenured relationship."[208] A tenured position is a relationship that is significantly different from a non-tenured relationship and provides the faculty member with academic freedom that encourages the expression of new ideas without the fear of retribution.[209]

After determining that payments made to tenured faculty members were provided in the exchange for the tenured faculty member's relinquishment of their contractual and constitutionally protected tenure rights, the Eighth Circuit held that the payments were not remuneration for services; the payments were not "wages."[210] Because the payments are not remuneration for services, the payments are not subject to FICA taxation.[211]

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202. *Id.* at 604.
203. *Id.* at 605.
204. *Id.*
205. *Id.*
206. *Id.*
207. *Id.*
208. *Id.*
209. *Id.*
210. *Id.* at 607.
211. *Id.*

VIII. THE INTERNAL REVENUE SERVICE HAS EXPRESSED ITS RELUCTANCE TO FOLLOW THE NDSU DECISION OUTSIDE OF THE EIGHTH CIRCUIT

Subsequent to the Eighth Circuit's decision in *NDSU*, the IRS announced its non-acquiescence. On December 31, 2002, the Office of Chief Counsel for the Department of the Treasury, Internal Revenue Service, noted its disagreement with the *NDSU* decision.[212] After noting its disagreement with the Eighth Circuit's decision, the Office of the Chief Counsel issued the following recommendation:

> Non-acquiescence.
>
> Although we disagree with the decision of the Court, we recognize the precedential effect of the decision to cases appealable to the Eighth Circuit, and therefore will follow it within that circuit only with respect to cases that have the exact facts as this case; that is, cases involving payments to college or university professors made in exchange for the relinquishment of their tenure rights. We will continue to litigate our position in cases having different facts in the Eighth Circuit, and in all cases in other circuits.[213]

On December 31, 2001, the Internal Revenue Service issued an additional Internal Revenue bulletin announcing its non-acquiescence to the *NDSU* decision.[214] The Internal Revenue bulletin states the following:

> The Commissioner does NOT ACQUIESE in the following decision:
>
> *North Dakota State University v. United States, 84 F. Supp. 2d 1043 (D.N.D. 1999), aff'd. 255 F.3d 599 (8th Cir. 2001).*

The Internal Revenue Service, through its Internal Revenue bulletin and through the Office of Chief Counsel, clearly expressed the intent of the Internal Revenue Service not to follow the decision issued by the Eighth Circuit in *NDSU*.

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212. Action on Decision, CC-2001-08 (Dec. 31, 2001) *available at* http://www.unclefed.com/ForTaxProfs/irs-aod/aod1-08.pdf.

213. *Id.*

214. 2001-53 I.R.B. 631 (Dec. 31, 2001).

IX. CONCLUSION

The Eighth Circuit has recognized that the unique nature of tenure that gives rise to the existence of a property interest. Tenure provides faculty members with the freedom of expression essential to the free exchange of ideas and encourages the development of new ideas without the fear of retribution against the faculty member. It is the unique nature of tenure that compels the conclusion that the purchase of a faculty member's tenure is not a remuneration for services but is instead the purchase by the institution, from the employee, of a valuable property interest. As such, a payment made to purchase a faculty member's tenure is not "wages" and is not subject to FICA taxation.