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TAX LAW: ONE OF JUDGE WEBB'S HOBBIES

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I. INTRODUCTION

One duty of Judge Webb's law clerks is keeping the chambers' library materials up-to-date. One canon is to never throw out the prior versions of tax materials when the updates arrive. Many people may not know that Judge Webb has a particular interest in tax law. Judge Webb has shared stories of preparing taxes dating back to his days in private practice in Grafton, North Dakota. This was prior to today's commonplace personal computers, tax preparation programs, the Internet, and e-filing; this would have been in the days of true "pencil sharpening." Tax preparation was a "bread and butter" element of his private practice days. Notwithstanding his positions in public service, where livelihood emanates from the public coffers,[1] politically he was, and philosophically he is, fairly conservative—appointed United States Attorney and district judge by a Republican President. His stated bottom line position on tax issues is to the effect that "everybody has to pay their fair share under the law, but they do not have to pay more than their fair share." In other words, there is nothing improper with understanding and applying the exemptions provided in the tax code.

As a federal judge, Judge Webb has had opportunities to comment on tax law issues. I will highlight two fairly recent cases, *United States v. Farm Credit Services of Fargo, ACA*[2] and *North Dakota State University v. United States*,[3] where issues with little published precedent were presented to his court.

II. *UNITED STATES V. FARM CREDIT SERVICES OF FARGO, ACA*

In *Farm Credit Services of Fargo*, the federal government was seeking repayment of a declared erroneous refund made to the defendant, Farm

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1. Others may have commented on his tenure as a state's attorney, officer in the North Dakota Army National Guard, United States Attorney, in addition to his present service as United States District Judge.

2. No. CIV. A3-97-29, 1998 WL 1776582 (D.N.D. Sept. 29, 1998).

3. 84 F. Supp. 2d 1043 (D.N.D. 1999).

Credit Services of Fargo, ACA (Fargo-ACA).[4] The issue before the court, on a fully stipulated record, was whether income attributable to Fargo-ACA's long-term real estate mortgage loans and related loan servicing was exempt from federal income tax.[5] In Judge Webb's opinion, the exemption was explicitly authorized, the refund was not made erroneously, and thus no repayment was due.[6]

The court in its memorandum opinion recapped the history and purpose of the Farm Credit System in the United States.[7] The Farm Credit Act of 1971[8] was enacted to "provide for an adequate and flexible flow of money into rural areas, and to modernize and consolidate existing farm credit law to meet current and future rural credit needs."[9] Congress had determined that it was necessary to provide sound, adequate, and constructive credit and related services to farmers and ranchers, their cooperatives, and select farm-related businesses.[10] The Act of 1971 established Federal Land Banks (FLBs) to provide long-term mortgage lending and Federal Intermediate Credit Banks (FICBs) to provide short- and intermediate-term production lending.[11] Federal Land Bank Associations (FLBAs) serviced long-term real estate mortgage loans made to their members by the FLB and could also, if authorized, directly provide long-term loans.[12] FLBAs were exempt from income taxation.[13] Production Credit Associations (PCAs) were established to provide short- and intermediate-term loans and services related to such loans,[14] but unlike FLBAs, PCAs were not exempt from federal income taxation.[15]

In an effort to strengthen the Farm Credit System, Congress enacted the Agricultural Credit Act of 1987 (Act of 1987).[16] Under the Act of 1987, Congress mandated the merger of each district's FICB and FLB, forming

4. *Farm Credit Servs. of Fargo*, 1998 WL 1776582, at *1.

5. *Id.*

6. *Id.* at *5.

7. *Id.* at *1-*2.

8. Farm Credit Act of 1971, Pub. L. No. 92-181, 85 Stat. 583 (codified as amended at 12 U.S.C. §§ 2001-2279cc (2000)).

9. *Farm Credit Servs. of Fargo,* 1998 WL 1776582, at *1 (quoting Farm Credit Act of 1971, Pub. L. No. 92-181, 85 Stat. 583 (codified as amended at 12 U.S.C. §§ 2001-2279cc)).

10. *Id.*

11. *Id.*

12. *Id.*

13. 12 U.S.C. § 2098 (2000).

14. *Id.* § 2075.

15. *Id.* § 2077.

16. Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568 (1988).

the successor entity Farm Credit Bank (FCB).[17] FCBs are exempt from federal income taxation.[18] The Act of 1987 encouraged, but did not mandate, the merger of FLBAs and PCAs forming an Agricultural Credit Association (ACA).[19] ACAs perform the functions previously performed by FLBAs and PCAs—providing long-term real estate mortgage loans, short- and intermediate-term loans, and related services to qualified borrowers. Unlike other institutional lenders in the Farm Credit System, the operation of ACAs is directed by incorporation of or reference to other code sections.[20]

The defendant, Fargo-ACA, was formed by the merger of a FLBA and a PCA.[21] For the 1990 tax year, Fargo-ACA treated all of its income derived from lending and servicing activities as subject to federal income taxation.[22] In 1994, Fargo-ACA filed an amended return seeking a refund of tax payments attributable to functions previously performed by the FLBA entity.[23] Later that year, the IRS made the requested refund.[24] In 1996, The IRS notified Fargo-ACA that the refund was erroneous and sought repayment of the refund.[25] The defendant's refusal to make the repayment led the government to bring an action in district court to recover the alleged erroneous refund.[26]

The court acknowledged that exemptions and exclusions from federal taxation could not be implied.[27] The court found that the exemption enjoyed by the FLBAs, which derived income from providing and servicing long-term real estate loans, applied equally to the restructured ACA, which was "merely the continuation of the local FLBA and PCA with identical powers and obligations."[28] The court reasoned that "[s]ince no corporate powers or obligations unique to the ACA are provided [in the Code], it is obvious that the ACA can only function under the auspices of the incorporated sections of the chapter explicitly referenced, specifically those

17. United States v. Farm Credit Servs. of Fargo, ACA, No. CIV. A3-97-29, 1998 WL 1776582, at *1 (D.N.D. Sept. 19, 1998).
18. 12 U.S.C. § 2023.
19. *Id.* § 2279(c)(1).
20. *Farm Credit Servs. of Fargo*, 1998 WL 1776582, at *2.
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.* at *3.
28. *Id.*

sections applicable to the pre-merger entities."[29] The Court further reasoned that

> [t]o conclude that Congress intended to deny the continuance of the exemption from federal income tax on income earned from long-term lending activities, which has been exempt since 1916, would be illogical and absurd. . . . This is especially so upon a simple reading of the Act of 1987: Congress means to provide financial assistance to the agricultural industry, not create obstacles.[30]

The court also acknowledged that looking to legislative intent in this case was improper.[31] If the applicable statutes were ambiguous, the case would be "moot as tax exemptions must be explicit and unambiguous."[32] Nonetheless, the court did comment that there was nothing in the legislative history that eliminated the continuance of the historical exemption of income associated with long-term lending.[33]

Finally, the court addressed the apparent ban on exemptions for new corporate instrumentalities unless set out in the tax code.[34] The court observed that 26 U.S.C. § 501(c) was not controlling since a general law is not binding upon a subsequent Congress.[35] In rejecting the government's argument, the court further noted that the government itself had taken an inconsistent position as it had conceded that FCBs were exempt from federal income taxation notwithstanding that the exemption was new and not set out in the tax code.[36]

The government appealed the matter to the Eighth Circuit Court of Appeals where the case lingered for years, due to a stipulation by the parties. Ultimately, the matter settled on undisclosed terms without the Eighth Circuit rendering an opinion.

III. *NORTH DAKOTA STATE UNIVERSITY V. UNITED STATES*

In *North Dakota State University*, the court tackled another tax refund case.[37] North Dakota State University (NDSU) had been audited in 1995

29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.* at *4.
34. *Id.*
35. *Id.*
36. *Id.*
37. N.D. State Univ. v. United States, 84 F. Supp. 2d. 1043, 1045 (D.N.D. 1999).

and assessed for Federal Insurance Contributions Act (FICA) taxes[38] for, among other things, payments made to tenured faculty members and administrators under their early retirement programs.[39] Whether FICA taxes were owed depended on whether the payments at issue were "wages" as defined by the applicable law.[40] NDSU paid the assessment, filed an administrative claim for a refund that was denied, and ultimately filed a refund suit in federal district court.[41]

NDSU argued that early retirement payments made to administrators and tenured faculty members were not wages for purposes of FICA taxation.[42] The court held that payments made to the administrators under the early retirement program were wages for FICA withholding purposes since the administrators were at-will employees with no property interest in their position, and that the amount of the payment was based on factors traditionally used to determine employee compensation, such as the value of services performed, the length of employment, and the amount of prior wages.[43] However, and more significantly, the court found that early retirement payments made to the tenured faculty members were not wages, but rather payments made in consideration for the relinquishment of tenure right, that is, for the purchase of a property interest.[44] The court clearly defined tenure as a constitutionally protected property interest in continued employment, comparable to a contract right.[45] The court noted a lump-sum payment received by an employee as consideration for the cancellation of a contract of employment is not subject to FICA taxes.[46]

The government appealed this opinion to the Eighth Circuit as well. The Eighth Circuit affirmed Judge Webb's decision holding that payments made to tenured faculty under a state university's early retirement program are not subject to FICA taxation, but early retirement payments made by a state university to administrators employed at-will are "wages" subject to FICA taxation.[47] These opinions may affect various individuals in comparable circumstances. For example, public school teachers in North

38. 26 U.S.C. §§ 3101-3128 (2000).
39. *N.D. State Univ.*, 84 F. Supp. 2d. at 1045.
40. *Id.* at 1047.
41. *Id.* at 1045.
42. *Id.* at 1048.
43. *Id.* at 1049.
44. *Id.* at 1050.
45. *Id.* at 1051.
46. *Id.* at 1051-52.
47. N.D. State Univ. v. United States, 255 F.3d 599, 609 (8th Cir. 2001).

Dakota enjoy statutorily granted property rights in their employment,[48] and thus, it would follow that any lump-sum payments made to public school teachers under an early retirement program would not be subject to FICA withholding.[49]

IV. ON A PERSONAL NOTE

I am grateful for the opportunity to have worked for Judge Webb. He is a fine teacher, mentor, lawyer, and judge. He holds high expectations of those who work for him, but inspires through modeling his own high work ethic and dedication as a public servant. He has good, plain common sense; he knows the value of prompt decision-making. He is not elitist; he is always open to speaking publicly in order to bring a greater understanding of the law to the public he serves. Judge Webb has a strong commitment to do right and be fair. The bar and the public have been and will continue to be well served by the Honorable Rodney S. Webb.

48. *See generally* N.D. CENT. CODE §§ 15.1-15-01 to -12 (Supp. 2001) (setting out the contractual rights of teachers in North Dakota).

49. *See N.D. State Univ.*, 255 F.3d at 609 (determining that lump-sum payments under a university's early retirement program are not subject to FICA taxation).