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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

BLUE LAKE RANCHERIA and BLUE LAKE RANCHERIA ECONOMIC DEVELOPMENT CORPORATION, Plaintiffs, V. UNITED STATES OF AMERICA, Defendant.	No. **C-08-04206-SC** **PLAINTIFFS' NOTICE OF MOTION AND MOTION FOR SUMMARY JUDGMENT; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF** **Date: December 4, 2009** **Time: 10:00 A.M.** **Place: Courtroom No. 1, 17th Floor**

PLEASE TAKE NOTICE THAT on Friday, December 4, 2009, at 10:00 a.m. or as soon thereafter as counsel may be heard, before the Honorable Samuel Conti, United States District Judge, in Courtroom No. 1, 17th Floor, 450 Golden Gate Avenue, San Francisco, California, Plaintiffs Blue Lake Rancheria (the "Tribe") and Blue Lake Rancheria Economic Development Corporation (collectively "Plaintiffs") will move for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. Plaintiffs seek summary judgment on their claims to recover from the United States payments under the Federal Unemployment Tax Act ("FUTA") that were paid by the Tribe's wholly owned business enterprise, Mainstay Business Solutions ("Mainstay"), and related interest and penalties, for calendar years 2003 and 2004. This Motion for Summary Judgment is based upon this Notice of Motion and Motion, the accompanying Memorandum of Points and Authorities, and the declarations of Eric Ramos, Jonathan E. Strouse, Anne Sparks, Kathleen M. Nilles and Michael Hanson, and exhibits thereto, and upon other such matters as may be presented to this Court at or before the time of hearing.

Dated: October 9, 2009

Respectfully Submitted,

HOLLAND & KNIGHT LLP

/S/ David Gonden
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MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION OF THE ISSUE

Internal Revenue Code ("Code") 26 U.S.C. § 3306(c)(7) exempts service performed "in the employ" of an Indian tribe or its wholly-owned businesses from liability under FUTA. Congress added this exemption in 2000 to treat Indian tribes and their businesses like state and local governments and to promote Indian tribal economic development and self-sufficiency. Section 3306(c)(7) exempts tribally-owned businesses from federal unemployment tax, and allows such businesses, like other governmental employers, to satisfy their unemployment liabilities by reimbursing the state for actual unemployment claims, *i.e.*, the "reimbursement method," rather than paying experience-rated unemployment taxes.

Mainstay, a wholly-owned employee staffing and leasing business of the Tribe, understood that it was exempt from FUTA taxes and eligible to use the reimbursement method for 2003 and 2004. But because its exempt status had not been finally determined, Mainstay did the following:

- It paid the federal portion of FUTA (0.8% of its FUTA wage base) and filed protective claims for refund with respect to such payments for 2003 and 2004.
- It applied to the State of California and other jurisdictions in which it was operating to pay its unemployment liabilities on a reimbursement basis.
- As soon as the State of California determined that Mainstay, like other governmental employers in California, was eligible to pay its unemployment liabilities using the reimbursement method, Mainstay promptly paid the State of California more than $6 million for the unemployment claims filed by its workers in 2003, 2004 and 2005.

Declaration of Michael Hansen ("Hansen Dec.") ¶¶ 16-18.

But the IRS's position was that Mainstay was eligible to be treated as a governmental employer under FUTA only as to a small portion of the employees to whom Mainstay paid wages, and thus denied Mainstay's 2003 and 2004 refund claims. The IRS concluded that Mainstay was "most likely not" the common-law employer of Mainstay's workers in 2003 and 2004, without considering whether Mainstay and its customers could be co-employers. It also concluded that Mainstay was not entitled to the exemption even if it was the statutory employer of those workers under 26 U.S.C. § 3401(d). It reasoned that eligibility for the exemption was based on common-law, rather than statutory employer status, even though the exemption does not use either the term "employer" or "employee." Effectively, the IRS concluded that Mainstay

was liable for federal FUTA tax, on the one hand, but was not eligible for the exemption from that very tax that Congress granted to tribal governments and businesses on the other.

This motion addresses whether Mainstay's employees performed services "in the employ of an Indian tribe" such that Mainstay is eligible for the FUTA exemption under 26 U.S.C. § 3306(c)(7) for 2003 and 2004. It further addresses whether Mainstay may be held liable for FUTA tax, given the interdependent federal/state unemployment scheme embodied by 26 U.S.C. §§ 3306(c)(7) and 3309, the determination by an Administrative Law Judge that Mainstay can pay its unemployment obligations as a reimbursing employer under the California unemployment code, and that Mainstay has already reimbursed substantial unemployment claims relating to its employees for the two tax years in question in reliance upon that determination.

II. SUMMARY OF ARGUMENT

Mainstay is exempt from FUTA tax under the 26 U.S.C. § 3306(c)(7) exemption for Indian tribal governments and businesses. First, although Mainstay is not the sole common law employer of the individuals on whose behalf it paid taxes, it does not need to be the sole common law employer to satisfy the § 3306(c)(7) exemption. The language, structure, legislative history, and purpose of the exemption show that it covers the relationship between Mainstay and its workers. Moreover, given Congress' creation of a dual federal-state unemployment system in which states are granted significant authority to determine whether tribes qualify as reimbursing employers, this Court should respect the decision of the California ALJ that Mainstay is exempt.

Mainstay also satisfies the exemption as the co-employer of the individuals at issue. The IRS recognizes that two entities can both be the employer of an individual if service to one does not involve abandonment of service to the other. Here, service for Mainstay's clients did not involve abandonment of the individuals' service to Mainstay, and Mainstay exercised substantial control over all the workers at issue.

Alternatively, Mainstay qualifies for the exemption as the statutory employer of the workers under 26 U.S.C. § 3401(d). That section states that the entity that controls the payment of wages is the employer for all FUTA tax liability purposes except for the definition of wages, which

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does not apply here. The IRS's claim that Mainstay does not qualify for the exemption as the statutory employer is based on inapposite authority. Fundamentally, the IRS's claim that Mainstay is simultaneously liable for federal FUTA taxes but is not eligible for the tribal governmental exemption flouts Congress's specific intention to exempt tribal employers and constitutes an improper attempt to whipsaw Mainstay.

III. LEGAL FRAMEWORK AND UNDISPUTED FACTS

A. Federal Commitment to Support Indian Tribes' Sovereign Status

The Supreme Court has long recognized Indian tribes as "distinct, independent political communities . . . from time immemorial." *Worcester v. Georgia*, 31 U.S. 515, 559 (1832). Indian tribes' "claim to sovereignty long predates that of our own Government." *McClanahan v. State Tax Commission of Arizona*, 411 U.S. 164, 172 (1973). In recognition of Indian tribes' sovereign status, Congress and the Executive Branch have expressed an overriding goal of "encouraging tribal self-sufficiency and economic development," *California v. Cabazon Band of Mission Indians*, 480 U.S. 202, 216 (1987), a goal that is "not within reach if the Tribes cannot raise revenues and provide employment for their members" through the operation of commercial businesses. *Id.* at 218-19. Congress's overriding goal" extends to the promotion and protection of off-reservation tribal commercial ventures. *Kiowa Tribe of Okla. v. Mfg. Tech., Inc.*, 523 U.S. 751, 759-60 (1998).

Congress has extended to Indian tribes the same exemptions from some employment statutes afforded to other governmental entities. *See* 42 U.S.C. §§ 2000e(b)(1), 12111(5)(B)(i); *see also* 110 Cong. Rec. 13702 (1964) ("amendment would provide to American Indian tribes in their capacity as a political entity, the same privileges accorded to the U.S. government and its political subdivisions, to conduct their own affairs and economic activities without consideration of the provisions of [Title VII]"). The commitment of Congress to promote tribal government and economic development has been "embodied in numerous federal statutes." *New Mexico v. Mescalero Apache Tribe*, 462 U.S. 324, 334-335, & n.17 (1983).

B. Overview of the Federal-State FUTA Scheme

FUTA is a coordinated state-federal taxation scheme designed to fund unemployment

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coverage. The two-part scheme consists of (1) a 6.2 percent federal tax, which is reduced to 0.8 percent after a credit for state unemployment taxes, and (2) a state unemployment insurance ("SUI") tax. 26 U.S.C. §§ 3301, 3302. The U.S. Department of Labor ("DOL") must review a state's unemployment insurance statutes, regulations and plans to confirm that they meet federal standards. 26 U.S.C. § 3304(a)-(e). When the federal government amends FUTA, the DOL notifies the states of such changes and requires, reviews, and approves the conforming state law amendments. *Id.*

1. The Federal Tax Exemption for Governmental Employers

The FUTA tax is imposed on every employer having individuals in its employ if wages of $1,500 or more are paid to such individuals in any calendar quarter. 26 U.S.C. § 3306(a). But state and local governmental employers have long been exempted from federal tax by excluding service in the employ of a governmental employer from the term "employment." *See* Section 3306(c)(7). Further, 26 U.S.C. § 3309(a)(1)(B) provides that if service is excluded from "employment" by virtue of paragraph (7) of § 3306(c), the governmental employer must be permitted to elect to satisfy its state unemployment liabilities using the "reimbursement method."

2. Extension of the Governmental Exception to Tribes

On December 21, 2000, President Clinton signed into law the Consolidated Appropriations Act of 2001, P.L. 106-554, which incorporated by reference the Community Renewal Tax Relief Act of 2000 ("the 2000 Act"). The 2000 Act amended FUTA to treat Indian tribes and wholly-owned tribal businesses as "governments" for FUTA purposes, to exempt Tribes from the federal portion of the FUTA tax, and to require states to allow tribal businesses to pay for unemployment claims through the reimbursement method. The 2000 Act amended 26 U.S.C. § 3306(c)(7) to define the scope of services exempt from federal FUTA tax:

> "service performed in the employ of a State, or any political subdivision thereof, **or in the employ of an Indian tribe, or any instrumentality** of any one or more of the foregoing which is wholly owned by one or more States or political subdivisions or Indian tribes." (Emphasis added)

H.R. 5662, Sec. 166. The definition of "Indian tribe" was also revised for unemployment tax purposes to include any federally-recognized Indian tribe and "any subdivision, subsidiary, or

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business enterprise wholly owned by such an Indian tribe." *See* 26 U.S.C. §3306(u). The 2000 Act also amended 26 U.S.C. § 3309, which requires coordination between the FUTA system and the state unemployment system for governmental employers. Specifically, it amended 26 U.S.C. § 3309(a)(2) to provide that, in the case of "services performed in the employ of an Indian tribe," the tribe or tribal business must be allowed either to make regular tax payments to the state unemployment fund or to reimburse the fund for any unemployment benefits paid to its employees. It further amended 26 U.S.C. § 3309(d) to state: "[t]he State law shall provide that an Indian tribe may make contributions for employment as if the employment is within the meaning of section 3306 or make payments in lieu of contributions under this section. . . ." *Id;. see also* 26 U.S.C. § 3304(a)(6)(B) ("payments (in lieu of contributions) with respect to service to which section 3309 (a)(1) applies may be made into the State unemployment fund on the basis set forth in section 3309 (a)(2)"). Congress thus provided that, in lieu of an Indian tribe's FUTA tax obligation, the tribe can elect to pay "into the state unemployment fund amounts equal to the amounts of [unemployment] compensation attributable under the state law to such service." *Id.* § 3309(a)(2), 3309(d).

The legislative history demonstrates a broad congressional intent to exempt tribes and their businesses from FUTA liability: "an Indian tribe (including any subdivision, subsidiary, or business enterprise chartered and wholly owned by an Indian tribe) is treated like a non-profit organization or State or local government for FUTA purposes (i.e., given an election to choose the reimbursement treatment)." H.R. Conf. Rep. 106-1033, p. *1000 (2000). Other legislative history also confirms that Congress intended the exemption of tribes from FUTA tax to further the long-held federal goal of promoting tribal economic development and self-sufficiency. [1]

[1] A letter sent by numerous congressmen to President Clinton supporting the amendments noted that the prior treatment of Indian tribes like corporate employers rather than governments had resulted in tribes being taxed for "the FUTA program's administrative costs" and [requires them] to pay the corporate rate for the program's benefit costs rather than the pay-as-you-go system that is made available to other governments." *See* Declaration of Kathleen Nilles in Support of Plaintiffs' Motion for Summary Judgment ("Nilles Dec."), Exh. 2. The letter expressly stated that "treating tribal governments as corporate entities . . . is a breach of tribal sovereignty." In response, then-President Clinton sent a letter stating that the amendments "will benefit each and every one of the over 500 federally recognized tribes across the country." *Id.*, Exh. 4.

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C. Conforming Changes to the California Unemployment System

In January, 2001, the U.S. Department of Labor directed all states to amend their unemployment laws by October, 2001 to conform to the 2000 Act. California did so. Section 802(a) of the California Unemployment Insurance Code (the "Cal. UI Code") now provides that "any 'Indian tribe'" or wholly-owned tribal business "for which services are performed that do constitute employment under Section 605 may, in lieu of the contributions required of employers, elect to finance its liability for unemployment compensation benefits, extended duration benefits, and federal-state extended benefits" as a reimbursing employer. Cal. UI Code Section 605 now provides that the term "'employment' includes "all service performed by an individual . . . for any . . . Indian tribe, if the service is excluded from employment . . . solely by reason of paragraph (7) of section 3306(c) of that act." These amendments were reviewed and approved by the U.S. Department of Labor. 26 U.S.C. § 3304.

D. Formation and Operation of Mainstay as A Wholly-Owned Tribal Business.

In May 2003, the Tribe, a federally-recognized Indian tribe,[2] formed Mainstay as a wholly-owned tribal enterprise to operate an employee leasing and staffing business. Declaration of Eric Ramos ("Ramos Dec.") ¶ 1, 4; Hansen Dec. ¶ 1. Mainstay hired and provided employees, on a temporary or permanent basis, to small and medium-sized businesses principally located in California. Hanson Dec. ¶ 2. As an employee leasing company, Mainstay entered into a Standard Customer Agreement with each of its clients, and hired the client's employees as its own. *Id.* As an employee staffing company, Mainstay hired the employees of its temporary staffing company clients who were assigned or reassigned as "temps." *Id.* In either case, Mainstay hired the client's rank and file employees and the client's supervisors. Declaration of Anne Sparks ("Sparks Dec.") ¶ 3, 12.

During 2003-2004, Mainstay used three principal forms of Standard Customer Agreements. Hansen Dec. ¶ 5 and Exs. 1-3. All of the Agreements stated that Mainstay employed all of the personnel and that Mainstay maintained the following contractual rights and/or responsibilities:

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[2] *See* Rev. Proc. 2008-55, 2008-39 I.R.B. 768; 73 Fed. Reg. 18553 (April 4, 2008).

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to recruit, screen, and hire employees for assignment at the client's business; to investigate harassment and discrimination claims and terminate employees; to determine and set the level of pay and fringe benefits for employees; and to maintain all personnel files. Hansen Dec. ¶ 5 and Ex. 1, ¶ 1-5; Ex. 2, ¶ 1-4; Ex. 3, ¶ 1-4. Mainstay would pay employees, withhold, remit, and report taxes, and issue forms W-2 for and to employees; furnish worker's compensation coverage for employees through either a tribal program or statutory coverage; and provide unemployment, general liability, and fidelity insurance for employees in addition to employee benefits. *Id.* In return, clients were required to furnish Mainstay with employee job descriptions, written notice of any material change in an employee's assignment, and records of employees' time worked for payroll purposes. *Id.* ¶ 6. The clients also agreed to undergo safety training and risk management programs under Mainstay's direction, notify Mainstay of harassment complaints so Mainstay could investigate and report back to the complainant, and notify Mainstay of any decision to involuntarily terminate an employee so Mainstay could consult with the client regarding the decision and, if appropriate, override the decision. *Id.*

Mainstay also imposed specific, ongoing obligations on both employees and clients. When Mainstay signed a contract with a new client, its Human Resources ("HR") Managers would conduct an initial site visit with employees and supervisors to explain the Mainstay relationship. Sparks Dec. ¶ 2; Hansen Dec. ¶ 7. In the employee meetings, the HR Manager would tell employees that Mainstay would be their new employer, and the HR Manager would further review Mainstay's employment policies, ensure that each employee filled out all Mainstay new hire paperwork (including an employment application, acknowledgment and other forms), and answer questions. *Id.* The HR Manager would also tell employees that daily work activities would be directed by supervisors at the worksite (who also became Mainstay employees), but that wages, benefits, employment rules and related policies, and personnel decisions would be directed by Mainstay. Sparks Dec. ¶¶ 3-4.

The HR Manager also gave each employee a copy of Mainstay's Employee Handbook. Sparks Dec. ¶¶ 4, 5 and Ex. 1. The introduction to the Handbook informed employees that they were employed by Mainstay, that Mainstay was owned by a sovereign Indian tribal government

and that their rights against Mainstay were limited as a result, and that they would not be paid unless they acknowledged and agreed to the Tribe's sovereign status. *Id*; Employee Handbook, pp. 5-6. It then covered Mainstay's employment policies such as performance evaluations, attendance, workplace harassment, drug, alcohol and security policies, and a description of prohibited conduct and discipline, and also explained the benefits and leave rights Mainstay provided. *Id.* ¶ 10. The Handbook specifically directed employees to contact the Mainstay HR Manager – whose contact information was listed prominently throughout the Handbook – regarding all questions about their employment, a point the HR Manager reiterated in the employee meetings. *Id.* ¶¶ 8-9.

Each employee was required to sign the Employee Handbook's "Receipt Acknowledgment" to certify that they had read and "agree to abide by the terms and conditions of Mainstay's policies as summarized in this handbook;" that they understood that Mainstay was tribally owned and managed according to applicable Tribal policies and procedures; and that Mainstay retained the right to end the employment relationship at will. *Id.* ¶¶ 6-7; Handbook pp. 7, 24.

The HR Manager would also meet with the client's managers and supervisors – who also were being hired by Mainstay – to review the new hire paperwork and Employee Handbook and to explain Mainstay's Management Guide, which set forth the Mainstay policies and procedures that the supervisors had to follow. *Id.*. ¶¶ 11-12. The HR Managers conducted follow up meetings with supervisors to answer questions and confirm that Mainstay's policies were being followed. *Id.*¶ 12. They emphasized that because the employees were hired by Mainstay, the supervisors must contact Mainstay to discuss an employee's discipline or discharge, and the client did not have the authority to terminate the employment of an employee without Mainstay's approval. *Id.* They provided certain clients with ongoing support, including job descriptions, wage rate analysis, pre-employment screening, offer letters, guidance and updates on changes in employment law and Mainstay's policies, and access to consultation with Mainstay's labor and employment counsel. *Id.* ¶ 13.

The HR Managers were involved in employee discipline and discharge decisions. Clients were directed to notify them about harassment and discrimination complaints, and the HR

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managers would either guide or conduct the investigation. *Id.* ¶ 14. The HR Managers also instructed clients on making and documenting discipline and discharge decisions, and even overrode unauthorized or otherwise inappropriate termination decisions. *Id.* ¶ 15. Finally, Mainstay attempted to place employees who were laid off, or who were terminated but who otherwise demonstrated that they could be productive employees elsewhere, with other clients. Hanson Dec. ¶ 7; Sparks Dec. ¶ 16.

Mainstay offered employee benefits, including group health and dental insurance, short-term and long-term disability insurance, life insurance, and a noncontributory 401(k) Plan, if the client so chose. Hansen Dec. ¶ 11. Mainstay handled employee benefit plan enrollment and eligibility, and all issues relating to employees' continuation of health insurance under COBRA. *Id.* During 2003 and 2004, Mainstay also handled all aspects of, and issues relating to, all employees' worker's compensation and unemployment insurance claims. *Id.* ¶ 10.

Mainstay had complete responsibility for all payroll obligations. Mainstay's contracts required the client to pay its invoice for all employee wages at least one day prior to the date Mainstay was obligated to pay wages, but Mainstay was obligated to pay the employees even if it did not receive payment from the client. *Id.* ¶ 13. Mainstay's sole recourse against a client for late or non-payment of its invoice(s) was to charge fees and interest, terminate the contract and initiate collection proceedings, or write off all or part of the invoice as a bad debt. *Id.* ¶¶ 13-14. For example, the total amount of receivables unpaid at the time Mainstay paid wages was $722,095.91 as of June 30, 2004, and the total amount of Mainstay's accounts receivable that was older than 60 days as of June 30, 2004 and September 30, 2004 was $273,338.81 and $320,498.61, respectively. *Id.* ¶¶ 14-15.

For both 2003 and 2004, Mainstay issued Forms W-2 to its employees and filed Forms W-2 and W-3 with the appropriate taxing authorities. *Id.* ¶ 12. In 2003, Mainstay remitted to the Internal Revenue Service ("IRS") $6,092,995.98 in income tax withholding and $11,305,711.35 in FICA and Medicare taxes. In 2004, Mainstay remitted to the IRS $17,741,862.06 in income tax withholding and $41,880,077.30 in FICA and Medicare taxes. Declaration of Jonathan E. Strouse ("Strouse Dec.") ¶ 5.

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During 2003 and 2004, Mainstay required that all clients comply with its direction and guidance to manage risks and promote employee safety. Mainstay's risk management group conducted worksite visits to ensure a clean and safe workplace, and wrote reports and made recommendations if Mainstay determined that the client was a high safety risk. Hansen Dec. ¶ 8. On dozens of occasions during 2003-2004, Mainstay was sued in court or before an administrative agency by a current or former employee. Sometimes the lawsuit or administrative complaint named only Mainstay, and sometimes it named both Mainstay and the client. *Id.* ¶ 10.

E. Use of Mainstay's Profits

Although a portion of Mainstay's profits have been retained in order to grow and sustain the business, the rest of the profits have been used to provide traditional government functions both on and around the reservation to benefit the Tribe and people in the surrounding communities, and for charitable purposes. Ramos Dec. ¶ 5. On the reservation, the Tribe uses Mainstay's profits to fund infrastructure improvements; to offer Tribal members reasonably priced home improvement loans; and to fund trade school and college scholarships for Tribal members, non-Tribal Native Americans, and others in the local community. *Id.* ¶ 6. The Tribe similarly provides a host of traditional governmental functions in areas surrounding the reservation that the Tribe believes are neglected by local government. *Id.* ¶ 7 and Ex. 1. Also, the Tribe engages in significant charitable activities. It operates a Foundation, which made grants of $1,500,000 from its inception in January 2002 through year-end 2005. *Id.* ¶ 8 and Ex. 2. It also made additional charitable donations, largely funded out of Mainstay's profits, of $61,205 in 2003; $210,018.52 in 2004; and $258,658.20 in 2005. These charitable contributions went principally to the Blue Lake Elementary School, to Humboldt County to hire and compensate two deputy sheriffs, and to food programs for the poor. *Id.* ¶ 9 and Exs. 3-5.

Mainstay's profits have substantially improved life on and around the reservation. Historically, the majority of Tribal members received non-Tribal public assistance, few completed high school, and alcoholism, drug abuse, and various health problems were prevalent. The Tribe's housing stock, water supply, sewage disposal, and roads were all grossly substandard. Because of Mainstay and the Tribe's other business enterprises, the tribal members

no longer require public assistance, and alcohol and substance abuse is at an all-time low and declining. Further, there is virtually no unemployment among Tribal members, college attendance is now the norm among Tribal members, and virtually all Tribal members have medical coverage. *Id.* ¶ 10.

F. Determination of Mainstay's Status Under The Dual Federal-State Unemployment Scheme.

In 2003, Mainstay registered with the State of California and applied to satisfy its unemployment insurance liabilities on a reimbursement basis. A dispute arose between Mainstay and the California Employment Development Department ("EDD") over whether Mainstay was entitled to reimbursing employer status and an evidentiary hearing was held. EDD argued that, because most of Mainstay's employees were not performing services "directly" for the Tribe, Mainstay could not use the reimbursement method. Following the evidentiary hearing, which included testimony by Victor P. Thines, Revenue Agent Indian Tribal Specialist for the Internal Revenue Service, concerning the meaning and effect of the 2000 FUTA amendments, a California Administrative Law Judge (the "ALJ") decided that Mainstay was entitled to pay its unemployment insurance liabilities on a reimbursement basis under FUTA's dual federal-state unemployment insurance scheme. *See Blue Lake Rancheria v. Employment Dev. Dep't*, Case. No. 1367761(T) (December 2, 2005); Strouse Dec. Ex. 3.

The ALJ held that the employees were employed by and performed services for Mainstay and that such services were "excluded from employment under the Federal Unemployment Tax Act solely by reason of section (7) of section 3306(c) of that act." *See id.* at 7. The ALJ found as a matter of fact that Mainstay was an "employing unit that contracts with clients or customers to supply workers to perform services for the client or customer and performs all of the following functions:

1. Negotiates with clients or customers for such matters, as time, place, type of work, working conditions, quality and price of services;

2. Determines assignments or reassignments of workers even though workers retain the right to refuse specific assignments;

3. Retains authority to assign or reassign a worker to other clients or customers when a worker is deemed acceptable by a specific client or customer;

4. Assigns or reassigns a worker to perform services for a client or customer;

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5. Sets the rate of pay for a worker whether or not through negotiation;

6. Pays the worker from its own account or accounts;

7. Retains the right to hire and terminate the workers."

Id. at 6. The ALJ rejected the argument that Mainstay had to be the **direct** recipient of the services of the employees it provided to qualify for reimbursing employer status. *Id.* at 6-7. Based on his conclusion that Mainstay's employees perform services in the employ of Mainstay for purposes of 26 U.S.C. § 3306(c)(7) and that Mainstay was "wholly owned by the tribe," the ALJ ruled that Mainstay could be a reimbursing employer with respect to all employees it paid. *Id.*

Following that decision, Mainstay paid the State of California more than $6 million to reimburse the State for all unemployment insurance claims related to the workers it paid in 2003, 2004, and 2005. Hansen Dec. ¶¶ 16-18. Mainstay also filed claims for refund of FUTA taxes it paid in 2003 and 2004 in the amounts of $722,047 and $1,283,892, respectively. Strouse Dec. ¶ 1-2. The IRS denied both refund claims; this action followed. *Id.* It is undisputed that the refund claims were timely filed and that this Court has subject matter jurisdiction over this action.

V. LAW AND ANALYSIS

A. Summary Judgment Standard

Rule 56 of the Federal Rules of Civil Procedure mandates entry of summary judgment where the moving party demonstrates the absence of a genuine issue of material fact and entitlement to judgment as a matter of law. *See* Fed. R. Civ. P. 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). Where, as here, the only disputes relate to the legal significance of undisputed facts, the controversy is suitable for summary judgment. *See Thrifty Oil Co. v. Bank of Am. Nat'l Trust and Savings Ass.*, 322 F.3d 1039, 1045 (9th Cir. 2003).

B. Mainstay Satisfies the Section 3306(c)(7) Exemption

While Mainstay is not the sole common law employer of its employees, when read properly in light of the canons of statutory interpretation the 26 U.S.C. § 3306(c)(7) exemption does not require Mainstay to be the sole common-law employer. The exemption is not based upon status

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as an "employer" or "employee." Because the exemption reasonably can be read to cover Mainstay, this Court should so read it under the Indian law canons of interpretation.

1. Applicable Principles of Statutory Interpretation

Statutory interpretation starts with the statute's plain meaning, *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004); *Beecham v. United States,* 511 U.S. 368, 372 (1994); *see also Massachusetts v. Morash,* 490 U.S. 107, 115 (1989) ("statutory interpretation is "not … guided by a single sentence or member of a sentence, but looks to the provisions of the whole law, and to its object and policy"). Statutory meaning is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole. *See Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). Moreover, courts assume that "identical words used in different parts of the same act are intended to have the same meaning." *Sorenson v. Sec'y of Treasury,* 475 U.S. 851, 860 (1986). Where the statutory language is clear and consistent with the statutory scheme, it is conclusive. *Molski v. M.J. Cable, Inc.*, 481 F.3d 724, 732 (9th Cir. 2007).

Finally, where, as here, the dispute involves a statute passed for the benefit of Indian tribes, the "Indian sovereignty doctrine … provide[s] a backdrop against which the applicable treaties and federal statutes must be read." *Okla. Tax Comm'n v. Sac and Fox Nation*, 508 U.S. 114, 123-24 (1993); *see also New Mexico v. Mescalero Apache Tribe*, 462 U.S. at 334. "[T]he standard principles of statutory construction do not have their usual force in cases involving Indian law." *Montana v. Blackfeet Tribe of Indians*, 471 U.S. 759, 766 (1985). Rather, "when [a court] is faced with two possible [statutory] constructions, the choice between them must be dictated by a principle deeply rooted in [the Supreme] Court's Indian jurisprudence: '[s]tatutes are to be construed liberally in favor of Indians, with ambiguous provisions interpreted to their benefit.'" *Yakima v. Confederated Tribes*, 502 U.S. 251, 269 (1992). Also, agency decisions involving the interpretation of statutes about Indian tribes are not entitled to *Chevron* deference. *Cobell v. Norton*, 240 F.3d 1081, 1101 (D.C. Cir. 2001). This is because "the rule of liberally construing statutes to the benefit of the Indians arises not from ordinary exegesis, but from

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principles of equitable obligations and normative rules of behavior applicable to the trust relationship between the United States and the Native American people." *Id.*

2. FUTA Structure and Relevant Provisions

This case concerns the meaning of the exemption from FUTA tax adopted for the benefit of Indian Tribes and their businesses, codified at 26 U.S.C. § 3306(c)(7). Specifically, it concerns the meaning of the phrase "service in the employ of" an Indian tribe, and whether the individuals to whom Mainstay paid wages in 2003 and 2004 performed services in Mainstay's employ within the meaning of that exemption.

It is critical to understand the relationship between the liability-imposing provisions of the FUTA statute and the exemption for the benefit of Indian Tribes. 26 U.S.C. § 3301(a) imposes liability for unemployment taxes on employers with respect to individuals in their "employ," while 26 U.S.C. § 3306(c)(1) – (21) provides exceptions to that tax liability.

> Code Section 3301(a) imposes on every employer (as defined in section 3306(a)) for each calendar year an excise tax, with respect to having individuals *in his employ*, equal to 6.2 percent … of the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c)) (emphasis added).

Notably, this section imposes the tax on an employer "with respect to having individuals in his employ…" It does not use the term "employee" or require the individuals to whom wages are paid to qualify as the common law employees of the employer. *See Indep. Petroleum Corp., v. Fly*, 141 F.2d 189, 190 (5th Cir. 1944) (noting that Congress used the phrase "in the employ" rather than "employee" when construing the identical provision in FUTA's predecessor statute).[3]

Under 26 U.S.C. § 3301(a), the term "employer" means "with respect to any calendar year, any person who during any calendar quarter in the calendar year or the preceding calendar year

[3] The Social Security Act of 1935 used the same "in the employ" language when determining whether a specific type of "employer" was subject to its provisions. In 1939, the Social Security Act of 1935 was incorporated in the Internal Revenue Code, §§ 1600-1611, where it was named the "Federal Unemployment Tax Act." *See United States v. Bernstein*, 179 F.2d 105 (4th Cir. 1949). The Federal Unemployment Tax Act of the 1939 Code was repealed by section 7851(a)(3) of the 1954 Internal Revenue Code. *See* 42 U.S.C. §502, "References in Text."

paid wages of $1,500 or more . . . ." *Id.* §3306(a)(1)(A). Mainstay fits this definition because it paid "wages," which is defined as "all remuneration for employment" under 26 U.S.C. §3306(b), of $1,500 or more to employees in each calendar quarter of 2003 and 2004.

26 U.S.C. §3306(c)(7), however, exempts from federal unemployment tax:

> "service performed in the employ of a State, or any political subdivision thereof, **or in the employ of an Indian tribe, or any instrumentality** of any one or more of the foregoing which is wholly owned by one or more States or political subdivisions or Indian tribes." (Emphasis added)

The term "Indian tribe" includes any federally-recognized Indian tribe, as well as any wholly-owned business enterprises of a tribe. *See id.* §3306(u). Like 26 U.S.C. § 3301, § 3306(c)(7) does not use the term "employee" or require that the excluded services be performed by common law employees. It merely requires that the service be performed "in the employ" of a Tribal business. Thus, the term "in the employ" are the operative words in both 26 U.S.C. §3301(a) and § 3306(c)(7); and neither section refers to common law employees.

3. Mainstay's Interpretation is Consistent with the Language and Context of the Exemption and Congressional Intent

It is undisputed that Mainstay is wholly owned by a federally-recognized Indian tribe. FUTA and applicable Treasury Regulations do not define the term "in his employ" or " in the employ," and there is, to our knowledge, no regulation defining the meaning of "service in the employ" of an Indian tribe for the 26 U.S.C. § 3306(c)(7) exemption. The terms should be defined using the canons of statutory construction: the FUTA statute should be read as a whole consistent with its context and purpose; the same terms in different sections of the statute should be given the same meaning; undefined terms should be given their ordinary meaning; and the statutory language should be interpreted for the benefit of Indian tribes.

Initially, the term "in the employ" should have the same meaning in both 26 U.S.C. §§ 3301(a) and 3306(c)(7). The statute imposes FUTA tax liability on an employer with respect to individuals "in his employ," and exempts service "in the employ" of an Indian tribe or tribal business from that liability. Thus, if individuals are paid wages "in the employ" of Mainstay for purposes of establishing FUTA tax liability under Section 3301, those same individuals should be considered as serving "in the employ" of Mainstay for purposes of the exemption. No other

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result is consistent with logic, the statute's use of the same word in different sections, or the clear congressional intent to grant a benefit for tribal businesses. If the individuals are not "in the employ" of Mainstay for purposes of the 26 U.S.C. § 3306(c)(7) exemption, they cannot be "in the employ" of Mainstay for purposes of establishing liability under 26 U.S.C. § 3301(a). The government cannot have it both ways: either Mainstay is exempt from FUTA tax because the individuals that it paid in 2003 and 2004 served "in the employ" of Mainstay, or it has no liability for FUTA tax because those individuals were not paid while in its employ. The government should not be allowed to whipsaw employers in furtherance of a tortured interpretation of the statute.

The other canons of construction further support this conclusion. The ordinary and customary meaning of the phrase "in the employ" read in context and in light of its purpose, applies to the relationship between Mainstay and all of its employees in 2003 and 2004. Black's Law Dictionary defines "employ" to mean "to hire." *Black's Law Dictionary* at 564 (8th ed. 2004). Merriam-Webster defines "employ" to mean "to use or engage the services of" and "to provide with a job that pays wages or a salary." *Merriam-Webster Online Dictionary* (2009). The American Heritage Dictionary of the English Language defines "employ" to mean "to hire or engage the services of (a person or persons); provide employment for; have or keep in one's service." *The American Heritage Dictionary of the English Language* (4 ed. 2006).

The individuals to whom Mainstay paid wages were in its "employ" because Mainstay provided them with the opportunity to work. Either Mainstay assigned or re-assigned its employees to its clients, or Mainstay hired the employees of a client and continued and maintained their employment. Moreover, Mainstay expressly required employees to acknowledge that they were employed by Mainstay, that they were subject to its rules and policies, and that Mainstay reserved the right to discharge them. Mainstay paid their wages for performing services on its behalf, and exercised continuing oversight, input, and authority relating to personnel decisions, including investigations, discipline and discharge. Mainstay could choose to keep an individual in its employ even if a client determined an individual's services were no longer needed. If Mainstay was unable to place the employee with another

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client, it laid off the employee and assumed financial responsibility for any unemployment claim the worker subsequently filed against Mainstay.

Mainstay likewise satisfies the phrase "service performed in the employ" within the ordinary and customary meaning of that term. *The American Heritage Dictionary, Fourth Ed., 2000*, Houghton Mifflin Company, defines "service" in two key ways: "Employment in duties or work for another: *has been in the company's service for 15 years"* and: "The performance of work or duties for a superior or as a servant: *found the butler's service to be excellent"* (Italics in original). Mainstay's employees performed "services" on behalf of Mainstay, and ultimately the Tribe, under this definition. Their services were Mainstay's main product. The services that they performed when Mainstay placed them with a customer clearly benefited Mainstay, which received income for their provision of services. This income was ultimately paid to the Tribe to fund tribal government expenses and social services in and around the Tribe's reservation, thereby benefitting the Native American and surrounding community, and promoting Congress' goal of encouraging tribal economic development and self-sufficiency. That such service also benefitted Mainstay's clients was, of course, the object of their employment with Mainstay, and is no different than any other service industry.

This interpretation of "in the employ" and "service performed in the employ" is consistent with FUTA as a whole and the congressional purpose in creating the exemption at issue. *See Robinson,* 519 U.S. at 341. Congress intended to benefit tribal employers and assist their economic development by exempting them from FUTA taxes. While Congress could have limited the excluded services to those provided by an employee "directly" to an employer controlling the performance of such services, or to "common-law" employment relationships, it did not do so. Interpreting the term "employ" as meaning "to hire" and "to provide with a job that pays wages or a salary" is consistent with the language, context and purpose, as well as the overall intent to benefit tribal employers.

This Circuit has recognized that "the rule that ambiguous statutes and treaties are to be construed in favor of Indians applies to tax exemptions." *United States v. Anderson*, 625 F.2d 910, 913 (9th Cir. 1980); *Ramsey v. United States*, 302 F.3d 1074, 1079 (9th Cir. 2002) ("any

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ambiguities as to whether an" express tribal tax exemption "applies to the tax at issue should be construed in favor of the Indians."); *see also Yakima*, 502 U.S. at 269. In *Ramsey* and *Anderson*, however, the tribes were not entitled to the requested tax exemptions because the language did not specify an exemption for tribes. Here, in contrast, there is an express exemption that expressly covers Indian Tribes and tribal businesses such as Mainstay. Although the language, structure, legislative history, and purpose of 26 U.S.C. § 3306(c)(7) and the FUTA scheme demonstrate that the exemption applies to Mainstay, even if it is ambiguous, that ambiguity must be construed in Mainstay's favor. Mainstay's interpretation of the phrase "in the employ" "can reasonably be construed to confer []exemptions." *Anderson*, 625 F.2d at 910. Particularly given that Congress' specific intent was that the exemption specifically benefit tribal businesses and treat them identical to governments, the Indian law canons of construction confirm congressional intent and bolster Mainstay's showing that it qualifies for the 26 U.S.C. § 3306(c)(7) exemption.

4. The Dual Federal-State Unemployment System Plus the California Decision Further Demonstrate That Mainstay Is Entitled to the Exemption.

The dual federal-state system created by the 2000 FUTA amendments gives state unemployment administrators a significant role in determining whether Tribes qualify for the exemption from FUTA tax and treatment as reimbursing employers. The nature of the dual federal-state system, coupled with California's conclusion after a full-blown evidentiary hearing that Mainstay is entitled to reimbursing employer status, further demonstrate that Mainstay is entitled to the 26 U.S.C. § 3306(c)(7) exemption from FUTA tax.

Congress required states to establish procedures for Indian tribes and tribal businesses to qualify as reimbursing employers. *See* 26 U.S.C. §§ 3304 and 3309. California adopted conforming amendments to its UI Code establishing procedures to determine whether a tribe qualifies as a reimbursing employer. *See* Cal. UI Code §§ 605 and 802. Those amendments, which were approved by the DOL pursuant to congressional direction, expressly require the State of California to determine whether services for which a tribal business pays wages are excluded from the term "employment" "solely by reason of paragraph (7) of section 3306(c)" – the exact issue presented by Mainstay's claims in this action. The essential role that Congress established

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for states in determining whether Indian tribes and their businesses qualify as reimbursing employers exempt from FUTA tax shows that Congress expected that states would make decisions regarding a tribal business' status as an exempt reimbursing employer and those final decisions would be respected.

The State of California has decided that Mainstay qualifies as a FUTA-exempt reimbursing employer within the meaning of 26 U.S.C. §§ 3306(c)(7) and 3309. A California ALJ presided over an evidentiary hearing in which both sides were represented by counsel, cross-examined witnesses, and filed post-hearing briefs. *See* Strouse Dec. Ex. 3. The hearing extensively examined Mainstay's operations, and witnesses included Victor Thines, IRS Revenue Agent Indian Tribal Specialist, who testified about the meaning of the 2000 Act amendments. The ALJ specifically concluded that the individuals to whom Mainstay paid wages in 2003 and 2004 performed services in Mainstay's employ and that those services were excluded from "employment" "solely by reason of paragraph (7) of section 3306(c)." Strouse Dec. Ex. 3, p. 6-7. This is not only the exact question presented here, but also a decision that the ALJ was authorized and bound to make to determine Mainstay's eligibility to be a reimbursing employer under the California amendments approved by the DOL. *See* 26 U.S.C. § 3309(a)(1)(B), Cal. UI Code § 802 (establishing conditions for reimbursing employer status).

The ALJ's decision was not appealed. Mainstay then fulfilled its obligations as a reimbursing employer by paying the State of California more than $6 million for the unemployment benefits paid to its employees in 2003, 2004 and 2005. By electing and complying with the reimbursing employer option created by the 2000 FUTA amendments, Mainstay has paid not only the costs of unemployment claims assessed with respect to the individuals it paid in 2003 and 2004, but also all that Congress required tribal businesses to pay.

Under the California decision, Mainstay's employees still receive State unemployment benefits, and Mainstay still pays (and has paid) for those benefits under the reimbursement method. Failing to treat Mainstay as an exempt reimbursing employer under these circumstances – where California has already concluded it qualifies as such – flouts congressional intent. Congress established a dual federal-state unemployment system under which states decide

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whether a tribal business qualifies to serve as a reimbursing employer. Here, the issue of Mainstay's entitlement to the exemption was fully and fairly litigated. It strains credulity to think that Congress envisioned a system whereby the DOL approves a state's amendments to its unemployment code allowing Indian Tribes to pay unemployment liabilities on a reimbursing basis, an ALJ finds that a Tribe is entitled to the exemption, the Tribe relies on the ALJ's determination and reimburses the state for all the unemployment claims filed by its employees, yet the IRS has the power to ignore these proceedings and treat tribes as non-exempt corporate entities subject to full federal unemployment tax.

Furthermore, such a result would inequitably require Mainstay to grossly overpay its unemployment tax liabilities. Ignoring California's decision to treat Mainstay as a reimbursing employer would require Mainstay to pay an additional $2,005,939 -- $722,047 for 2003, $1,283,892 for 2004 -- in FUTA taxes on top of the payments it has already made to reimburse unemployment claims for the same tax period. These amounts would be a windfall for the federal government, and would not be shared with the State of California to help fund federally mandated extensions of unemployment benefits or for other purposes.

The IRS's position – that Mainstay is liable to pay the tax but cannot qualify for the exemption – cannot be squared with the language of the exemption, the congressional purpose to benefit Indian tribes, or the dual-state federal unemployment scheme. The 26 U.S.C. §3306(c)(7) exemption, read in light of the canons of statutory interpretation, Congress' intent to treat Indian tribal businesses as governments to promote tribal economic development, and the intent to create a dual federal-state employment system under which states are delegated significant responsibilities, mandates that the term "service in the employ of" a tribal business be construed to include the services performed by Mainstay's workers and that Mainstay be deemed exempt from FUTA taxes for all wages it paid in 2003 and 2004.

C. Mainstay Is Exempt as the Co-Employer of The Individuals at Issue

In the alternative, Mainstay is exempt under 26 U.S.C. § 3306(c)(7) because it is the common law co-employer of the individuals to whom it paid the wages to which the disputed FUTA taxes relate and therefore, those individuals performed "service" in the employ of

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Mainstay. The common law of agency recognizes that "[a] single act may be done to affect the purposes of two independent employers." *Restatement (Second) of the Law Agency*, § 226. The IRS has applied this common-law co-employer test to determine FUTA liability. In Revenue Ruling 66-162, 1966-1, CB 234, the IRS considered the circumstances of a concessionaire that operated a leased department in a store as an independent contractor. The store considered the clerks in the department to be its employees and paid them wages. The store paid the clerks wages, gave them employee benefits, reported and paid the employment taxes, and charged these items as expenses to the concessionaire. While the store expected the employees to comply with its general rules and procedures, the concessionaire had the right to control and direct the sales' clerks work activities to insure a profitable operation. The concessionaire also approved any individual being hired to work in the department, and any reduction in force was within the discretion of the concessionaire and implemented by the store at the concessionaire's request.

On these facts, the IRS concluded that for purposes of both FICA and FUTA taxes, both the store and the concessionaire were co-employers of the clerks. The IRS ruled that "[a] person may be the servant of two masters, not joint employers, at one time and as to one act, if the service to one does not involve abandonment of the service to the other." (*citing Restatement of the Law of Agency*, 2d Ed., section 226.) The IRS reasoned:

> The store directs and controls [the employees] as to its general rules and procedures. At the same time, the concessionaire exercises the right to control and direct the activities of the sales clerks with respect to matters peculiarly pertinent to the sale of the product in order to insure the operation of the department in a manner profitable to the concessionaire. Thus, the sales clerks' services to one employer do not involve abandonment of services to the other. The store and the concessionaire act in conjunction in exercising the right of discharge. Accordingly, the sales clerks in the leased department are employees of both the store and the concessionaire.

The Ninth Circuit has cited this Revenue Ruling with approval, recognizing that an individual may be the common-law employee of both a staffing agency and its customer. *Vizcaino v. U.S. Dist. Court for the W. Dist. of Washington*, 173 F.3d 713, 723-25 (9th Cir. 1999).

The IRS confirmed its co-employer analysis in 2004, stating:

> "If a client company was the common law employer of workers it leased from the Taxpayer, the Taxpayer could also be a common law employer under the theory of co-employment. Under the common law doctrine of co-employment, a worker may have the status of employee with respect to more than one employer if service to one does not involve abandonment of service to the other. Therefore, two employers may

> employ a worker simultaneously. See, for example, Rev. Rul. 66-162, 1966-1 C.N. 234.

IRS Chief Counsel Advisory dated April 9, 2004, 2004 WL 759202 (IRS CCA). Furthermore, in determining co-employer status, the IRS recognizes that "it is not necessary that the employer actually direct or control the manner in which the services are to be performed; it is sufficient if he has the right to do so." Rev. Rul. 75-41, 1975-1 C.B. 323. It also recognizes that "the right to discharge is an important factor indicating that the person possessing that right is an employer." In Rev. Rul. 75-41, the IRS relied solely on the fact that the entity had entered into contracts granting the right to control in finding employer status.

In that same ruling, the IRS considered a staffing corporation that recruited individuals to perform services for customers on the customers' premises with the customers' equipment. The customer could require that the individuals cease performing services but could not affect the relationship between the individual and the staffing corporation, and the staffing corporation retained the right to terminate the individuals. The IRS concluded that the individuals were employees of the staffing corporation.

Under these authorities, Mainstay is at least the co-employer of the individuals that it places with customers. Mainstay, like the store in Revenue Ruling 66-162, hires the employees and maintains its own general rules and procedures. Mainstay's contracts give it the right to hire, and it retained the right to discharge employees. Employees were required to acknowledge in writing their obligation to follow Mainstay's employment policies, and to acknowledge in writing that they were employees of a sovereign tribal entity, Mainstay, and could be discharged at the will of Mainstay. Mainstay provided significant continuing oversight and direction concerning the overall employment relationship and management of the employees, directed, and sometimes conducted, the investigation of harassment and discrimination claims, and controlled and could override discharge decisions. It retained the right to and did place discharged workers with other Mainstay clients and paid their unemployment claims. It provided all employee benefits and maintained all personnel documents. And the clients' on-site supervisors were also Mainstay employees. Furthermore, service to the customer does not mean abandonment of service to Mainstay and *vice versa*. While the workers performed services at the client's worksite, they

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also performed the services that Mainstay provided to the customers and for which Mainstay receives its remuneration. Indeed, the client's supervisors were Mainstay employees. Thus, within the meaning of the Restatement of Agency on which the IRS itself relies, the service provided by Mainstay's employees are "done to affect the purposes of two independent employers." *Restatement (Second) of the Law Agency*, § 226, cmt. 9. Mainstay is at least a co-employer of the employees in question, and those individuals therefore perform "service in the employ" of an Indian tribe. Plaintiffs are entitled to summary judgment for this reason.

D. Mainstay Is Exempt As The Statutory Employer

Alternatively, if Mainstay is not the common law co-employer of the employees to whom it paid wages in 2003 and 2004, it is exempt from FUTA tax as the statutory employer. The statutory employer – the entity that controls the payment of wages – is the "employer" for all purposes relating to FUTA tax collection except for the definition of wages, an exception not relevant here. It is undisputed that Mainstay controls the payment of wages. Mainstay is thus the "employer" for purposes of whether the "services" for which it paid wages were rendered "in the employ" of an Indian Tribe.

26 U.S.C. § 3401(d) provides that the term "employer" means "the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person," except that "if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term 'employer' (except for purposes of subsection (a)) means the person having control of the payment of such wages." 26 U.S.C. § 3401(d)(1). Section 3401(d) applies to FUTA taxes. In *Otte v. United States,* 419 U.S. 43, 51 (1974), the Supreme Court held that the Section 3401(d)(1) definition of statutory employer applied to FICA taxes. "Courts have uniformly interpreted *Otte* to mean that [section] 3401(d) [statutory] employers are liable for . . . paying FUTA taxes ..." *Consol. Flooring Servs. v. United States*, 42 Fed. Cl. 878, 879 (1999). "[I]f the common law employer does not [] control the payment of the wages for ... services, then the person who does have such control steps into ... [the] shoes" of the common law employer for employment taxes. *In re Sw. Rest. Sys., Inc.,* 607 F.2d 1237, 1239 (9th Cir. 1979).

Furthermore, 26 U.S.C. § 3401(d) provides that the statutory employer is *the employer* of the individuals whose wages it pays for *all purposes* of tax liability with only one exception: it is not treated as the employer for purposes of section 3401(a), which defines "wages" for income tax withholding purposes. But that exception does not apply here. Section 3401(a) defines "wages" as "remuneration . . . for services performed by an employee for his employer." Under this definition, if the statutory employer were treated as the "employer," there would be no wages subject to income tax withholding because the statutory employer is not the employer for whom the employee performs services. The exception was added to ensure that the payments made by the statutory employer to the employees constitute wages subject to withholding. This *definition* of "wages" has no bearing upon the independent question of whether the individuals performed services in the employ of Mainstay in 2003 and 2004.[4]

If Mainstay is not the common law co-employer of the individuals for whom it paid the disputed FUTA taxes, it is the statutory employer. Mainstay established or approved each employee's rate of pay, paid all wages, and withheld all employment taxes. It was responsible for payment of wages to all of its employees even if it did not receive payment from clients. As the statutory employer, Mainstay stepped into the shoes of the common law employer of those individuals for FUTA tax liability purposes. Therefore, those workers' services were "in the employ" of Mainstay for purposes of the 26 U.S.C. § 3306(c)(7) exemption, Mainstay is exempt from FUTA tax for its payments to those workers, and Mainstay is entitled to a refund of the FUTA taxes it paid for 2003 and 2004.

[4] The IRS has relied upon Rev. Rule 54-471 and the decision of the U.S. Tax Court in *Cencast Servs., L.P. v. United* States, 62 Fed. Cl. 159 (2004) to support its position that a tribal business cannot be exempt under 26 U.S.C. § 3306(c)(7) if it is the statutory employer. Neither the 1954 Revenue Ruling nor the *Cencast* case support the IRS. In the Revenue Ruling, the governmental entity did not pay the wages and the Ruling did not address the issue presented here. *Cencast* is distinguishable for two reasons. First, *Cencast* did not involve a governmental employer and thus did not address the meaning of Section 3401(d) in connection with the 26 U.S.C. § 3306(c)(7) exemption. Second, the issue in *Cencast* directly addressed the definition of "wages" for purposes of FUTA tax liability. The definition of wages is the one issue with respect to which the statutory employer is not considered the employer. Under the plain language of Section 3401(d)(1), even as a statutory employer, the employer in *Cencast* was not the employer for purposes of determining the definition of the word wages. Here, however, the issue is the meaning of the separate phrase "in the employ" in the 26 U.S.C. § 3306(c)(7) exemption, an issue the *Cencast* court did not address.

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VII. Conclusion

This Court should hold, as a matter of law, that all the individuals to whom Mainstay paid wages in 2003 and 2004 performed "service in the employ" of Mainstay, a wholly owned tribal business; that such service is exempted from FUTA tax under Section 3306(c)(7); and that Plaintiffs are entitled as a matter of law to all of the FUTA tax refunds that they seek.

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Respectfully Submitted,

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