Case No. 10-15519

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Appeal from the United States District Court
Northern District of California, San Francisco
D.C. No. 3:08-cv-04206-SC

BLUE LAKE RANCHERIA; BLUE LAKE RANCHERIA ECONOMIC DEVELOPMENT CORPORATION,
Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

REPLY BRIEF OF APPELLANTS

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I. INTRODUCTION

The IRS asks this Court to ratify its game of "heads we win, tails you lose." The Court should reject the offer.

The IRS asserts that "FUTA *liability*, and any *exceptions* thereto, require a common-law employment relationship," and that the Tribe is not a "common-law" employer. IRS Brief at 34 (emphasis added). If the Tribe is not an "employer" however, it cannot be liable for FUTA taxes. Section 3301 of Title 26 U.S.C. [1] imposes FUTA liability on an "employer". Thus the IRS must rely on the fiction that an "employer" under section 3401(d)(1) is also an "employer" for purposes of FUTA. But the IRS insists that this is only the case for purposes of FUTA liability, not for the governmental exemption from that same liability.

The IRS is wrong for a number of reasons. FUTA tax liability attaches to both common-law and statutory employment relationships. Nothing in FUTA suggests that Congress intended the governmental exemption from that liability at issue here to be limited to common-law employers. The tribal government exemption was added decades after "statutory employers" were held liable under FUTA. Congress is presumed to have added the tribal governmental exemption with that knowledge. Moreover, Congress knew how to mandate a common-law

[1] Subsequent references are to Title 26 of the United States Code unless otherwise specified.

employment relationship – and did so in FUTA's definition of "employee" – but did not do so in defining "employment". In addition, FUTA's definition of "employment" includes the undefined phrase "person employing" another. Because it is undefined, a common definition should govern. The common definition of a "person employing" another is an "employer," which the Tribe plainly is. FUTA's use of the phrase "in the employ" in both sections 3301 and 3306(c)(7) suggest that they both mean "employer."

The federal policies involved weigh in favor of the Tribe's interpretation of section 3306(c)(7). The congressional act that added the tribal exemption to FUTA was designed to promote economic development in Indian tribes and other impoverished sectors of the economy. The IRS's interpretation would undermine those purposes. Moreover, the tribal government exemption from FUTA liability was passed for the benefit of Indian tribes and thus must be liberally construed in the Tribe's favor.

For these reasons, and the additional ones set forth below and in the Tribe's Opening Brief, the Tribe respectfully requests that the Court reverse the District Court's Order and judgment.

II. ARGUMENT

A. "Employment" For FUTA Purposes Includes Both Common-Law And Statutory Employment Relationships

The IRS's fundamental argument is that "employment" for FUTA purposes includes only common-law employment relationships. The IRS is wrong for a number of reasons.

1. The Governmental Exemption Is Not On Its Face Limited To "Common-law" Employment Relationships.

Congress amended FUTA in 2000 to add tribal governments to the governmental exemption. *See* Community Renewal Tax Relief Act of 2000 (the "Act") (§ 3306(c)(7)). By that time, the "statutory employer" doctrine's application to FUTA liability had been established for more than twenty years. *See Otte v. U.S.*, 419 U.S. 43 (1974); *In re Southwest Restaurant Systems*, 607 F.2d 1237, 1240 (9th Cir. 1979); *In Re Armadillo*, 561 F.2d 1382 (10th Cir. 1977).

By adding tribes to the governmental exemption from FUTA liability, in the context of well-established "statutory employer" liability, and without explicitly narrowing the scope of the exemption to common-law employment relationships, Congress must be presumed to have extended the exemption to all employment relationships generating FUTA tax liability. There is a strong presumption favoring the continuation of judge-made law. "The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation

of a judicially created concept, it makes that intent specific." *Midlantic Nat'l Bank v. New Jersey Dep't of Envt'l Protection*, 474 U.S. 494, 501 (1986) (internal quotation omitted).

The statutory employer doctrine was imported into FUTA two decades before Congress amended the statute in 2000 to extend the governmental exemption to Indian tribal governments. Congress did not limit the exemption's application to common-law employment relationships. Thus we should presume that Congress intended the exemption to apply to employment relationships that would otherwise create FUTA liability, be they statutory or common-law.

2. Congress Knew How To Specify A Common-Law Employment Relationship – And Did So In FUTA's Definition Of "Employee" – But Did Not Do So In Defining "Employment"

The IRS puts much emphasis on the fact that Congress defined "employee" with reference to FICA's common-law definition. § 3306(i). But the IRS ignores the fact that Congress did not similarly define "employment" with reference to a common-law definition. *See* § 3306(c). Congress knew how to specify a common-law employment relationship when it wanted to do so. The fact that Congress did so in defining "employee" but did not do so in defining "employment" raises an inference that it did not intend to limit "employment" exclusively to common-law relationships. *See, e.g., Whitfield v. United States*,

543 U.S. 209, 216 (2005) (noting that "Congress has imposed an explicit overt act requirement in numerous conspiracy statutes, yet has not done so in the provision governing conspiracy to commit money laundering"); *Dole Food Co. v. Patrickson*, 538 468, 476 (2003) (Congress knows how to refer to an "owner" "in other than the formal sense," and did not do so in the Foreign Sovereign Immunities Act's definition of foreign state "instrumentality"); *Meghrig v. KFC Western, Inc.*, 516 U.S. 479, 485 (1996) ("Congress ... demonstrated in CERCLA that it knew how to provide for the recovery of cleanup costs, and ... the language used to define the remedies under RCRA does not provide that remedy."); *Central Bank of Denver v. First Interstates Bank*, 511 U.S. 164, 176-77 (1994) (although "Congress knew how to impose aiding and abetting liability when it chose to do so," it did not use the words "aid" and "abet" in the statute and thus did not impose aiding and abetting liability); *Franklin Nat'l Bank v. New York*, 347 U.S. 373, 378 (1954) (finding "no indication that Congress intended to make this phase of national banking subject to local restrictions, as it has done by express language in several other instances").

Congress' express incorporation of the common-law definition of "employee" without similarly limiting "employment" to common-law employment relationships suggests that "employment" encompasses both statutory and

common-law employment relationships. The IRS's likely response, that "employment" is defined with reference to "employee," is addressed below.

3. The Term "Employer" May Reasonably Be Interpreted To Include A "Person Employing" Another

The IRS claims that only common-law relationships qualify as "employment" under section 3306(c). *See* Appelle's Response Brief ("IRS Brief") at 22-24. This is so, we are told, because section 3306(c)'s definition of "employment" uses the term "employee." FUTA in turn defines "employee" at section 3306(i) by incorporating FICA's definition of "employee" as meaning "'any individual who under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee.'" IRS Brief at 22 (*quoting* § 3121(d)).

But the IRS ignores the other relevant part of FUTA's definition of "employment." FUTA defines "employment" as "any service ... by an employee ***for the person employing him***...." § 3306(c) (emphasis added). Who is "the person employing him"? Neither FUTA nor the IRS define the phrase "person employing him." In the absence of a statutory definition, a court must "construe a statutory term in accordance with its ordinary or natural meaning." *FDIC v. Meyer*, 510 U.S. 471, 476 (1994). The "person employing" an employee is generally known as the "employer." "Employing" is the plural of "employ." *See*

Webster's New Twentieth Century Dictionary Unabridged, at 595 (2d ed. 1983). "[O]ne who employs" is generally known as an "employer." *Id.* It is undisputed that the Tribe is an "employer" for FUTA purposes. Thus the Tribe may reasonably understood to be "the person employing" its workers, and therefore within FUTA's definition of "employment" in section 3306(c).

4. The IRS's Interpretation Would Undermine Congress' Intent In Adding The Tribal Government Exemption

As noted above, the tribal government exemption was added to FUTA as part of the Community Renewal Tax Relief Act of 2000. That Act amended the Internal Revenue Code "to provide tax incentives for distressed areas ...." S. 3152, 106th Cong. 2d Sess.[2] It provided a broad range of tax incentives for distressed communities, affordable housing, urban and rural infrastructure, farmers, energy production and conservation. *See id.*

The Act was intended to "revitaliz[e] impoverished communities .... [and] encourage private sector equity investment in underserved communities throughout the country to ensure that all Americans share in our nation's economic prosperity." President Clinton's New Market's Initiative: Revitalizing America's Underserved

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[2] Available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=106_cong_bills&docid=f:s3152is.txt.pdf.

Communities (December 14, 2000).[3] "President Clinton has highlighted the potential of the nation's New Markets in three separate trips across America to underserved inner city and rural communities like ... the Pine Ridge Indian Reservation in S. Dakota." *Id.*

In addition to extending FUTA's governmental exemption to Tribes, that Act also established a new markets tax credit designed to "spur $15 billion in equity investment for business growth in low-and moderate-income rural and urban communities throughout the United States.... " *Id.* The Act also authorized $150 million in Small Business Administration loan guarantees, to be matched by $100 million in private equity, and providing an additional $30 million in technical assistance for small businesses, such as the Tribe's enterprise at issue here. *See id.*

The Act strengthened and expanded empowerment zones, providing an additional $110 million in discretionary investment for existing empowerment zones, expanded by 20% the empowerment zone wage tax credit, increased small business expensing and enhanced tax-exempt bonds to all empowerment zones. *See id.* The Act created 40 "Renewal Communities," and provided "targeted, pro-growth tax benefits," including "zero capital gains rate on the sales of certain assets

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[3] Available at http://clinton4.nara.gov/textonly/WH/new/html/Mon_Dec_18_154959_2000.html.

held for more than 5 years." *Id.* In addition, the Act "increases the Low-Income Housing Tax Credit by more than 40% over two years ...." *Id.*

Thus the purpose of the Act was *not* to increase federal government revenue from taxation, but rather to provide *tax credits* and federal loan guarantees to spur economic development activity in low- and moderate-income communities. The IRS's interpretation of the Act's extension of the governmental FUTA exemption to tribes would *undermine* Congress' purposes embodied in the 2000 Act. The Tribe's interpretation, on the other hand, furthers Congress' purpose by making development of tribally-owned businesses more attractive.

FUTA was enacted to "protect persons whose livelihoods is dependent upon finding employment in the businesses of others," and are " least able in good times to make provisions for their needs when ... unemployment may cut off their earnings." *Fahs v. Tree-Gold Co-op Growers of Florida*, 166 F.2d 40, 44 (5th Cir. 1948). Under the Tribe's interpretation, employees it lays off still receive unemployment benefits, and the Tribe reimburses the State for unemployment benefits paid to its former employees. *See* Opening Brief at 14; ER 108-09.

Thus the Tribe's interpretation of section 3306(c)(7) furthers congressional purposes and policies, whereas the IRS's interpretation undermines them.

5. *Cencast* Does Not Support The IRS's Interpretation

The IRS suggests that *Cencast Services, L.P. v. United States*, 62 Fed. Cl. 159, 180 (2004), supports its argument that "the tribal exemption does not relate to who is responsible for FUTA taxes ...." IRS Brief at 28. But *Cencast* does not provide any such support.

The plaintiff in *Cencast* failed to qualify as an "employer" not because FUTA applies only to common-law employers (as the IRS asserts), but rather because he claimed to be an "employer" in the one area that section 3401 *explicitly excludes* from its coverage. Section 3401(d) provides that the wage payer is the "employer" for all purposes other than the definition of "wages" found in section 3401(a).

Because Congress expressed only one limited area where the statutory employer definition does not control – calculating wages – the implication is that it does control for all other purposes. *See Andrus v. Glover Const. Co.*, 446 U.S. 608, 616-17 (1980) ("[W]here Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied").

Thus, for example, in *Demarest v. Manspeaker*, 498 U.S. 184, 188 (1991), the Court held that a statute requiring payment of an attendance fee to "a witness" applied to an incarcerated state prisoner testifying at trial. Because Congress had expressly excepted another category, detained aliens, from eligibility for these

witness fees, and had expressly excepted any "incarcerated" witness from eligibility for a different category of fees, "the conclusion is virtually inescapable ... that the general language 'witness in attendance' ... includes prisoners ...." *Id.* at 188.

Here, section 3401(d) provides only one exception from its definition of a statutory employer: it is "for purposes of subsection (a)" defining "wages." As noted in the Tribe's Opening Brief, the calculation of wages is not at issue here. *See* Opening Brief at 27.

The IRS discounts the Tribe's observation that *Cencast* did not address section 3401(d)'s meaning in connection with the section 3306(c)(7) exemption. But the IRS does not answer the Tribe's argument. Instead, the IRS makes the vague assertion that "*Cencast*'s relevance stems from its analysis of the employment relationship for FUTA purposes, a predicate to wages, not from its specific conclusion regarding wages." IRS Brief at 34.

So what does *Cencast* say about "the employment relationship for FUTA purposes"? The IRS does not say. The Tribe's reading of *Cencast* is that it affirms that a statutory employer is an "employer" under FUTA generally, but just not "for purposes of calculating the FICA and FUTA wage bases." *Cencast*, 62 Fed. Cl. at 180.

Finally, as the Tribe noted in its Opening Brief, *Cencast* is not binding in any event. *See* Opening Brief at 27. The *Cencast* litigation is still pending, and so the decision on which the District Court relied is not final. *See* ER 45-52. Moreover, as a decision by the Court of Federal Claims, it is not binding on this Court. *See U.S. v. Choate*, 576 F.2d 165, 198, n. 48 (9th Cir. 1978). For all of these reasons, *Cencast* is of no help to the IRS.

B. FUTA's Exemptions From Liability In Section 3306(c)(7) Must Be Read Together With The Liability Provisions In Section 3301

In its zeal to persuade this Court that only common-law employment relationships are eligible for the governmental exemption, the IRS asserts that the "term 'employment' is the cornerstone upon which FUTA liability is built, and establishes that FUTA *liability* turns on the existence of a *common-law* employment relationship." IRS Brief at 22 (emphasis added). *See id.* at 34 ("FUTA *liability, and any exceptions* thereto, require a common-law employment relationship") (emphasis added).

Of course, this position undermines the argument the IRS must make here, namely that the Tribe is a statutory employer under section 3401(d)(1) and thus is "liable for the payment of [FUTA] tax ...." IRS Brief at 6. If only common-law employers have FUTA liability, as the IRS appears to claim, and if the Tribe is not a common-law employer, as the IRS insists, then the Tribe has no FUTA liability.

The IRS's contradictory positions arise out of the reality that an exception to FUTA liability only makes sense if it corresponds to FUTA's liability provision. FUTA's provisions regarding liability and exemptions from that liability must necessarily be read together. The IRS wants to have the benefit of importing the statutory definition into FUTA, without affording the commensurate governmental treatment. This Court should not allow the IRS to have it both ways.

Congress articulated four elements that work together to establish FUTA liability. These are: (1) "employer"; (2) "individuals in his employ"; (3) "wages"; and (4) "employment." § 3301. Under section 3301's plain meaning, all four interrelated elements must exist and function together to establish FUTA liability. FUTA defines "Employer" with respect to "wages," "employee," "employer," *see* § 3306(a)(1), as well as to "employed," and "employment," *see* § 3306(a)(2), all in addition to the definition imported from section 3401(d)(1). FUTA defines "wages" in terms of "employment." § 3306(b). If "employment" only includes common-law employment, as the IRS claims, then as a statutory employer, the Tribe would not pay "wages" and thus have no FUTA liability. FUTA defines "employment" in terms of "service," "employee," and "person employing him." § 3306(c). The IRS concedes that exemptions from "employment" are intended to, and do, exempt service from "FUTA liability." IRS Brief at 23.

The IRS is asking this Court to ratify its game of "heads I win, tails you lose." Given the Federal governments' trust and fiduciary relationship with the Tribe, and its strong policy promoting tribal economic development, that is not a tenable position. *See, e.g.,* 25 U.S.C. §§ 4301(a) and (b) (promoting tribal economic development); *Morongo Band of Mission Indians v. FAA*, 161 F.3d 569, 574 (9th Cir. 1998) (trust); *California v. Cabazon*, 480 U.S. 202, 218-19 (1987) ("Self-determination and economic development are not within reach if the Tribes cannot raise revenues"); *United States v. Mitchell,* 463 U.S. 206, 225 (1983) (trust); *Seminole Nation v. United States*, 316 U.S. 286, 296-97 (1942) (U.S. has "charged itself with moral obligations of the highest responsibility and trust" towards Indian tribes);

Otte and its progeny import the "statutory employer" definition into FUTA to close a perceived loophole in FUTA liability. *See In re Southwest Restaurant Systems*, 607 F.2d 1237, 1240 (9th Cir. 1979); *In Re Armadillo*, 561 F.2d 1382 (10th Cir. 1977); *In re Terex Corp.*, 93 B.R. 127, 130 (Bkr. N.D. Ohio 1988); ER 19. But if the statutory employer is to be made liable for FUTA taxes, a "holistic" reading of FUTA liability and its exceptions, as well as fundamental notions of equity and fairness, surely require that they also be eligible for express exemptions from that same liability. *United Savings Ass'n v. Timbers of Inwood Forest Associates*, 484 U.S. 365, 371 (1988); *see, e.g., Brotherhood of Locomotive*

Engineers v. Atchinson, 516 U.S 152, 157 (1996). *See also U.S. v. Bethlehem Steel Corp.*, 315 U.S. 289, 312-13 ("the function of the judiciary is not so limited that it must sanction the use of the federal courts as instruments of injustice in disregard of moral and equitable principles which have been part of the law for centuries") (Frankfurter, J., dissenting).

For these reasons, the provisions imposing and exempting employers from FUTA liability must be read together.

C. FUTA's Use Of The Phrase "In the Employ" In Both Sections 3301 And 3306 Suggests That They Both Mean "Employer"

Congress used the phrase "in his employ" with respect to every employer in section 3301, imposing FUTA liability. It used the virtually identical phrase "in the employ" of an Indian tribe in section 3306(c)(7)'s governmental exemption. By using virtually identical language in these two related provisions of FUTA, Congress intended that they have the same meaning. *See* Opening Brief at 28-30. As the District Court conceded, "where an employer is an employer solely by virtue of his *statutory* relationship with an individual (i.e., a § 3401(d)(1) employer), that individual *is clearly 'in his employ'* for the purpose of establishing liability under section 3301." ER 22:15-18. Similarly, workers are "in the employ" of a statutory employer. § 3306(c)(7).

The IRS recognizes, as did the District Court, that the "in his employ" and "in the employ" phrases are virtually identical. *See* IRS Brief at 37; ER at 22. The IRS further acknowledges that the "'normal rule of statutory construction assumes that 'identical words used in different parts of the same act are intended to have the same meaning.'" IRS Brief at 37 (*quoting Sorenson v. Sec'y of Treasury*, 475 U.S. 851, 860 (1986); *Helvering v. Stockholms Enskilda Bank*, 293 U.S. 84, 87 (1934)).

But the IRS argues that the general rule should not apply here. Instead, it claims that the "in the employ" language is "found in such dissimilar connections" in FUTA sections 3301 and 3306(c)(7) "as to warrant the conclusion that they were employed in the different parts of the act with different intent." IRS Brief at 37 (*quoting Sorenson*, 475 U.S. at 860). What are these radically "dissimilar connections"? The first is in section 3301, imposing FUTA liability on "every employer." The second is in section 3306(c)(7)'s exemption from that very same liability. Contrary to the IRS 's conclusory allegation, the two "connections" fit together, hand in glove, addressing fundamentally the same issue: namely, the existence or non-existence of FUTA liability.

The IRS nevertheless insists that the two uses are so different as to require different meanings. It claims that section 3301's use of the phrase "in his employ" encompasses a statutory-employer relationship under *Otte* and its progeny, but that section 3306(c)(7)'s use of the identical phrase should be limited exclusively to

common-law employment relationships. IRS Brief at 37. But the IRS fails to demonstrate any such "dissimilar connections". *Id.* The only argument the IRS offers is to simply restate its desired conclusion, namely that section 3306(c) is limited "to a common-law relationship." *Id.* at 38-39. Again, the IRS offers no persuasive reasoning or authority to support its conclusion.

The IRS cites *Helvering v. Stockholms Enskilda Bank,* 293 U.S. 84 (1934), as supporting its "dissimilar connections" argument. But *Stockholms* actually supports the Tribe's position. There, a foreign corporation received a tax refund with interest. The IRS assessed income tax on the interest portion of the refund. The term "obligations" was at issue because section 958 provided that gross income of a nonresident alien included interest on "interest-bearing obligations of residents ..." *Stockholms*, 293 U.S. at 85. The bank argued that "the word 'obligations,' as it occurs in another part of the act, has been given a narrower construction ...." *Id.* at 86-87.

The Supreme Court noted that despite using the same word, "obligations," the two sections had vastly different purposes. One, section 954(b)(4), was intended to "aid the borrowing power of the federal government by making its interest-bearing bonds more attractive to investors. " *Stockholms*, 293 U.S. at 87. The other, section 958(a), was intended "for a different purpose; namely, to produce revenue, not to encourage loans in aid of the [federal government's]

borrowing power." *Stockholms*, 293 U.S. at 87. The Court concluded thus that "[t]he intent of Congress, therefore, in the one case, is fulfilled by giving the phrase a construction with the narrow purposes of section [§954(b)(4)]; and, in the other case, by a construction, if the phrase fairly admits of it, which will effect the obviously different statutory aim of section [958(a)]." *Stockholms*, 293 U.S. at 87-88.

Here, by contrast, the language at issue – "in the employ" – is used for a single purpose: namely, to determine whether FUTA taxes are to be paid. It is a condition of liability in section 3301, and a condition of the governmental exemption from that very same liability in section 3306(c)(7).

Thus the general rule that "identical words used in different parts of the same act are intended to have the same meaning," *Sorenson*, 475 U.S. at 860, applies, and "in the employ" must be given the same meaning in sections 3301 and 3306(c)(7). In both sections, "individuals in his employ" refers to an "employer," whether common-law or statutory.

D. The Revenue Rulings Predating *Otte* Do Not Support The IRS's Position

The Revenue Rulings relied on by the IRS and District Court all predate *Otte* and its progeny[4] As noted above, *Otte's* progeny has uniformly applied *Otte* to FUTA. Thus, the Rulings that the District Court relied on, and which the IRS defends, *see* IRS Brief at 30-32, fail to accurately state current law. For example, the IRS quotes Rev. Rul. 69-316, 1969-1 C.B. 263, for the proposition that while a statutory employer "is the 'employer' ... for purposes of income tax withholding" but not "for purposes of the ... Federal Unemployment Act." IRS Brief at 30. As of 1979, that simply was no longer the law. *See Southwest Restaurant*, 607 F.2d at 1240.

The IRS clings to Revenue Ruling 54-471, which the District Court also relied on, though it too is not helpful. In that Ruling, the State was the common-law employer, and was exempt from FUTA tax liability. The IRS believed – pre-*Otte* – that the statutory employer doctrine did not apply to FUTA tax liability. Thus the IRS had no occasion to, and did not, decide whether the statutory employer could be liable for, or exempt from, FUTA taxes. The Ruling nowhere purports to construe the relevant statutory term, "service in the employ," and nowhere states that only the common-law employer may qualify for the exemption.

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[4] Before 1974, the IRS asserted that section 3401(d)(1)'s definition of a statutory "employer" did not apply to FUTA. *See, e.g.*, Rev. Ruling 57-316.

See Rev. Rul. 54-471. The Tribe does not dispute that the common-law employer can qualify for the section 3306(7) exemption. Its position is that the exemption is not limited to the common-law employer. Revenue Ruling 54-471 does not even address, let alone refute, the Tribe's position.

The IRS acknowledges that Revenue Ruling 54-471, like all the others cited by the District Court, "preceded the Supreme Court's decision in *Otte* that I.R.C. § 3401(d)(1) applies in the context of FICA and FUTA ...." IRS Brief at 31. Yet the IRS inexplicably states that "the principle articulated in them remains viable." *Id.* How so? The IRS relies on the general principle that its own internal "interpretations long continued" are entitled to deference. *Id.* at 31-32. The cold fact of decades of intervening, contrary Supreme Court and Ninth Circuit precedent escapes the IRS's analysis.

Finally, the IRS claims that *Cencast* somehow revives these long-superseded Revenue Rulings. *See* IRS Brief at 32. As noted above and in the Tribe's Opening Brief (at 26-27), *Cencast* does no such thing.

E. The IRS Has No Answer To The Tribe's "Co-Common-Law Employer" Argument

The Tribe's Opening Brief noted that there may be co-common-law employers. *See* Opening Brief at 55-56. It also noted that the Supreme Court has expressly held that the existence of a common-law employment relationship is

determined by many factors and may not be established by reference to only one factor. *See id. at 56-57 (discussing and quoting Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 751-52 (1989) ("No one of these factors is determinative"). In addition, the Tribe noted that federal regulations expressly provide that it is not necessary that the employer "actually direct or control the manner in which the services are performed" in order to establish a common-law employment relationship. *See* Opening Brief at 57 (*citing* 26 C.F.R. § 31.3306(i)-1(b)).

The IRS has no answer to these authorities. Instead, it ignores this precedent and regulatory law and, just like the District Court, focuses exclusively on the obvious fact that the Tribe's clients had primary day-to-day control of workers' jobs. *See* IRS Brief at 45-47, 51. The Tribe never contended otherwise.

The District Court erred by failing to follow the Supreme Court's instruction in *Community for Creative Non-Violence*.

F. The California Unemployment Insurance Appeals Board Found That The Tribe Is Exempted From "Employment" Under Section 3306(c)(7)

The California Department of Unemployment Insurance Appeals Board held that the Tribe qualifies as a reimbursing employer for unemployment tax purposes. *See* Opening Brief at 46; ER 140-46. The State's determination of the Tribe's eligibility to pay as a reimbursing employer is, as a matter of both federal and state

statute, *predicated on* the Tribe's right to the 3306(c)(7) governmental exemption. *See* §§ 3309(a)(1)(B), 3309(a)(2); Cal. Unemp. Ins. Code §§ 802(a), 605(c); ER 144-45.

The IRS, like the District Court, ignores the predicate finding in the Baord's determination. The IRS claims that "[t]he Appeals Board's decision ... related to provisions of California law, not FUTA, and offers no real support for Blue Lake." IRS Brief at 51. The IRS focuses on the California statutory provision relating to a "leasing employer," claiming this that statutory provision somehow renders the Board's adjudication irrelevant. *See* IRS Brief at 52. Indeed, the IRS claims that the Board's decision that the Tribe "was eligible for the reimbursement method depended exclusively on the CUIC provision that extended the definition of employer to include a 'leasing employer.'" IRS Brief at 52 (*quoting* ER 145-46). But the IRS focuses on the wrong issue.

The California unemployment statute does indeed include the concept of "a leasing employer" in its definition of "employer." *See* Cal. Unemp. Ins. Code § 606.5(a). The Board's decision is relevant not for its finding that the Tribe is an "employer" – which is conceded here -- but instead for its finding that the Tribe is exempted from "employment" because "the service is excluded from employment under the Federal Unemployment Tax Act solely by reason of section (7) of section 3306(c) of that act." ER 144 (*citing* Cal. Unemp. Ins. Code § 605(a)).

The Board's holding was predicated on the Tribe's right to the 3306(c)(7) governmental exemption. *See* §§ 3309(a)(1)(B), 3309(a)(2); Cal. Unemp. Ins. Code §§ 802(a), 605(c); ER 144-45.

G. Statutes Passed For The Benefit Of Indian Tribes Must Be Liberally Construed In the Tribe's Favor

There can be no question that the amendment to FUTA extending the governmental exemption to Indian tribes and tribal entities was enacted for the benefit of tribes. As noted above, the amendment was part of the 2000 Act aimed at benefitting low- and moderate-income communities, and followed President Clinton's tour of an impoverished Indian reservation.

It is well-settled that "statutes passed for the benefit of dependent Indian tribes ... are to be liberally construed to favor Indians." *Bryan v. Itasca County*, 426 U.S. 373, 392 (1976). *See also Montana v. Blackfeet Tribe*, 471 U.S. 759, 766 (1985) ("[S]tatutes are to be construed liberally in favor of the Indians ...."). Thus, for example, in *California v. Cabazon Band of Mission Indians*, 480 U.S. 202 (1987), the Court found that the federal policy promoting tribal self-government and self-sufficiency, as reflected in numerous statues, was frustrated by state restrictions on the operation of bingo and card games, the profits from which were the tribes' primary source of income. *See id.* at 214-22.

For this reason also, section 3306(c)(7)'s governmental exemption should be read to apply the Tribe.

H. Any Ambiguity in FUTA's Governmental Exemption Must Be Interpreted in the Tribe's Favor

In addition to the liberality canon, it is also well-established that any ambiguity in the statutory language must be construed in the Tribe's favor: "'statutes are to be construed liberally in favor of the Indians, with ambiguous provisions interpreted to their benefit.'" *County of Yakima v. Yakima Indian Nation*, 502 U.S. 251, 269 (1992) (*quoting Montana v. Blackfeet Tribe*, 471 U.S. 759, 766 (1985)); *see also Iowa Mutual Ins. Co. v. LaPlante,* 480 U.S. 9 (1987); *Bryan v. Itasca County*, 426 U.S. 373, 392 (1976); *Ramsey v. U.S.*, 302 F.3d 1074, 1079 (9th Cir. 2002) ("any ambiguities as to whether an" express tribal tax exemption "applies to the tax at issue should be construed in favor of the Indians"); *U.S. v. Anderson*, 625 F.2d 910, 913 (9th Cir. 1980).

Section 3306(c)(7) was amended for the benefit of Indian tribes, and uses an otherwise undefined phrase, "in the employ" of an Indian tribe or tribal business. No legislative history provides a further definition of the scope of the exemption.

The District Court "disagree[d]" with the Tribe's interpretation of the phrase "in the employ" while noting that "FUTA never defines this phrase." ER 22. While the Tribe believes that the phrase "in the employ" should be interpreted

uniformly in sections 3301 and 3306(c)(7), if there is any question as to its meaning, this canon required the District Court to interpret it in favor of the Tribe, rather than against its interest, as the District Court in fact did.

Similarly, as noted above, the phrase "person employing" another is not defined in FUTA. While the Tribe believes that it should be interpreted as meaning an "employer," to the extent that FUTA's silence results in any ambiguity it must be interpreted in the Tribe's favor.

I. The Private Letter Ruling Conflicts With the IRS's Position Here

The Tribe's Opening Brief noted that in a private letter ruling, the IRS found that a worker selling pull tabs for a charity was the common-law employee of a charity but the statutory employee of a municipality. *See* IRS Private Letter Ruling 9237023; *see* Opening Brief at 30. The IRS noted that "Section 3306(c)(7) of the Code, pertaining to the FUTA, provides that services performed in the employ of a state, political subdivision, or instrumentality thereof are excepted from the definition of employment." *Id.* If the IRS did not believe that the municipality, as a statutory employer, had the benefit of the governmental exemption, there would have been no need to include this language in the ruling. Furthermore, the IRS stated that "[t]his ruling is applicable to any other individual engaged by the [municipality] under similar circumstances." *Id.*

Thus the IRS opined that even though the municipality was the worker's statutory employer and not her common-law employer, the governmental exemption of section 3306(c)(7) still applied. The Tribe urges the same outcome here. The IRS's claim here that "IRS Priv. Ltr. Rul. 9237023 does not conflict" with its position in this case is thus unpersuasive.

As the Tribe's Opening Brief noted, although private letter rulings may not be used or cited as precedent, *see* § 6110(k)(3), they nonetheless "do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws" and may provide evidence of the proper construction of the statute. *Hanover Bank v. Commissioner*, 369 U.S. 672, 686-687 (1962). Private letter rulings can provide persuasive authority for refuting the IRS's argument where the IRS takes inconsistent positions. *See Glass v. Commissioner*, 471 F.3d 698, 709 (6th Cir. 2006); *see also Niles v. United States*, 710 F.2d 1391, 1394 (9th Cir. 1983) (the IRS cannot act contrary to its administrative precedent when it would result in unequal treatment among taxpayers).

This also relates to the "overriding principle of equal tax treatment" by the IRS of taxpayers. *United States v. Kaiser*, 363 U.S. 299, 308 (1960) (Frankfurter, J., concurring). The "commissioner cannot tax one and not tax another with some rational basis for the difference." *Id.* Under these circumstances, such inequality

can be an "independent ground of decision that the Commissioner has been inconsistent." *Id.*

The fact that the IRS found the section 3306(c)(7) exemption is available to a municipality – but is not available to the Tribe – when both were determined to be statutory employers but not common-law employers, is yet another reason for this Court to reverse the District Court.

J. The Tribe Paid FUTA Taxes.

The IRS claims "[t]here is no evidence in the record suggesting that the wages invoiced to its clients do not cover the employment tax amounts that Mainstay paid to the IRS for its clients' employees." IRS Brief at 40. The IRS does not make any legal argument based on this claim, and thus its significance is unclear. It appears that the IRS may be claiming that there is no evidence that the Tribe, rather than its clients, actually paid the FUTA taxes at issue.

If that is the case, the IRS is wrong. The Standard Customer Agreement in the record clearly provides that the Tribe "will ... pay ... all taxes." ER 111. In addition, the record shows that the Tribe sent its customers "an itemized invoice for temporary services, based on hours shown on ... time cards ...." ER at 114. No mentioned is made of adding employment tax amounts to the hours shown on time cards.

In addition, the Declaration of Michal Hansen provides that the Tribe "withheld and reported taxes ... and furnished unemployment ... insurance for employees ...." ER 106 (¶ 5). Mr. Hansen declared that "[d]uring 2003 and 2004, Mainstay handled all aspects of, and issues relating to ... unemployment insurance claims." *Id.* at 107 (¶ 10). "Mainstay was responsible for compliance with all payroll-related obligations including the payment and remittance of withholding taxes ...." *Id.* (¶ 12). Mr. Hansen explained that "Mainstay's contract with the client required payment of its invoice for all wages to be paid in that pay period at least one (1) day prior to the date of the payroll deliver. However if the invoice was not paid in a timely matter, Mainstay was still obligated to pay its employees and still issued and delivered payroll checks." *Id.* (¶ 13). Mr. Hansen noted that "[o]n a regular and ongoing basis throughout 2003 and 2004, numerous Mainstay clients failed to pay Mainstay's invoices on a timely basis per the agreement ...." *Id.* at 108 (¶ 14). He declared that "[s]ome such receivables were ultimately collected, but others were never collected and ultimately written of the books in later years." *Id.* (¶ 15). Finally, after California determined that Mainstay was eligible to pay its unemployment liabilities on the governmental reimbursement method, "Mainstay promptly then paid the State of California more than $6 million for the unemployment claims filed by its workers in 2003, 2004 and 2005." *Id.* at 109 (¶ 18).

Thus, contrary to the IRS claim, the record does indeed contain evidence that the Tribe – and not its clients – paid employment tax amounts. Moreover, the record contains evidence that, at a minimum, the Tribe was not fully reimbursed by clients for the FUTA taxes it paid.

K. The Tribe Is Already In A Worse Position Than Other Governments, And The District Court's Defective Interpretation Of Section 3306(c)(7) Will Further Harm The Tribe

The IRS argues that the Tribe is "in precisely the same position as any other government, *viz.*, it could claim the I.R.C. § 3306(c)(7) exemption only for its common-law employees." IRS Brief at 53 n. 14. As discussed in depth above, this is wrong because section 3306(c)(7) is not limited to common-law employment relationships.

It is also wrong because it ignores the reality that "for much of the past two centuries, federal Indian policies inhibited tribal economic development. Allotment-era policies can be seen as an effort to place control of tribal economies, including tribal resources, in the hands of federal agencies or officials and resulted in the loss of two-thirds of tribal lands and resources." Cohen, Handbook of Federal Indian Law, at § 21.01 (2005 LexisNexis).[5] *See also* The Harvard Project

[5] *Cohen* is the leading treatise on the subject of federal Indian law, and has consistently and routinely been cited by the Supreme Court in federal Indian law cases since it was first published. *See, e.g., City of Sherrill, N.Y. v. Oneida Indian*

on American Indian Economic Development, Native America at the New Millennium 108 (2002).

"[T]he Indians have no viable tax base and a weak economic infrastructure. Therefore, they, even more than the states, need to develop creative ways to generate revenue." *Pueblo of Santa Ana v. Hodel*, 663 F.Supp. 1300, 1315 n.21 (D.D.C. 1987). The Indian Reorganization Act "sought to reverse this trend and improve tribal economic conditions by reviving tribal governments and chartering tribal business entities that would engage in economic development." *Cohen*, at § 21.01.[6] Despite modern federal policies of promoting tribal economic development – of which the 2000 amendment to FUTA at issue here is but one example – Indian tribes "continue to confront serious issues of poverty and its social consequences." *Id.* According to the Bureau of Indian Affairs in 1999 unemployment among reservation Indians was 43 percent, and as high as 85 percent on the poorest reservations. *See* U.S. Gen. Accounting Office, Economic

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Nation of New York, 544 U.S. 197, 204 (2005); *Oklahoma Tax Com'n v. Sac and Fox Nation*, 508 U.S. 114, 123 (1993); *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 139 (1982); *Santa Clara Pueblo v. Martinez*, 436 U.S. 49, 55 (1978); *Mescalero Apache Tribe v. Jones,* 411 U.S. 145, 159 (1973); *Williams v. Lee*, 358 U.S. 217, 219 (1959); *Sioux Tribe of Indians v. United States*, 316 U.S. 317, 325 n. 5 (1942).

[6] *See also* 25 U.S.C. § 461 *et seq.*

Development: Federal Assistance Programs for American Indians and Alaska Natives 3 (2001) (GAO-02-193).

The 2000 amendment to FUTA at issue here was designed to aid tribal economic development. The Tribe's interpretation of section 3306(c)(7) furthers that congressional policy, while the IRS's interpretation and the District Court's Order undermine it.

L. The District Court's Policy Concerns Are Unfounded and More Appropriately Left for Congress to Address Should They Materialize

Finally, the IRS echoes the District Court's policy fears that the Tribe's interpretation of the governmental exemption would allow for abuse. *See* ER 24; IRS Brief at 53. As the Tribe's Opening Brief explained, these fears are unfounded. In addition, they raise policy questions that are properly addressed to Congress.

The Tribe explained that tribal governmental employers, like states and their political subdivisions, do not avoid paying for unemployment benefits for former workers. The Tribe paid over $6 million in unemployment claims filed by its workers in 2003, 2004, and 2005 – fully reimbursing the State of California for the unemployment claims of its workers. ER 109. Moreover, it is unlikely that any tribal, state or local government agency that does not operate an employee staffing

business would permit a private employer to run its payroll through a government, both because of the risk of additional liability and the minimal tax savings of a mere $56 per employee. Establishing an employee staffing businesses requires significant infrastructure, capital, and knowhow. In addition to employment litigation exposure, being a reimbursing employer involves assuming the liability to pay wages from the employer's own account, and all associated payroll tax liabilities. *See* § 3401(d)(1) and Cal. Unemp. Ins. Code § 606.5(b). In times of high unemployment, a reimbursing employer's claims may easily exceed the amount of state taxes that are imposed on private employers.

Finally, the District Court has substituted its own policy judgments for those of Congress. Congress clearly intended Tribes and their economic development enterprises to be treated on par with other governmental entities under FUTA. This is in furtherance of the well-settled federal policy of promoting tribal economic development. *See, e.g.,* 25 U.S.C. §§ 4301(a) and (b). The District Court can not override that policy by imposing its own policy in the guise of statutory interpretation.

III. CONCLUSION

The Tribe respectfully requests that this Court reverse the District Court's Order and remand with instructions to enter a new order granting the Tribe's motion for summary judgment and denying the IRS' motion, and to enter judgment

in the Tribe's favor. The Tribe respectfully requests that the Court find that the individuals to whom the Tribe paid wages in 2003 and 2004 performed service in the employ of the Tribe; that such service is exempted from the federal portion of FUTA tax under section 3306(c)(7); and that Plaintiffs are entitled as a matter of law to the FUTA tax refunds sought in the Complaint.

Date: September 10, 2010

HOLLAND & KNIGHT LLP

/s Frank R. Lawrence
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Attorney for Appellants Blue Lake Rancheria; Blue Lake Rancheria Economic Development Corporation

CERTIFICATE OF COMPLIANCE WITH FED. R. APP. P. RULE 32(a) AND CIRCUIT RULE

I certify that this brief complies with the length limits set forth at Fed. R. App. P. 32(a)(7)(B) because this brief contains 6950 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

Date: September 10, 2010

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