No. 10-15519

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BLUE LAKE RANCHERIA and BLUE LAKE RANCHERIA ECONOMIC DEVELOPMENT CORPORATION,

Plaintiffs-Appellants

v.

UNITED STATES OF AMERICA,

Defendant-Appellee

ON APPEAL FROM THE JUDGMENT
OF THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

BRIEF FOR THE APPELLEE

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GLOSSARY

Appeals Board:	California Unemployment Insurance Appeals Board
Blue Lake:	Blue Lake Rancheria and Blue Lake Rancheria Economic Development Corporation
CUIC:	California Unemployment Insurance Code
ER:	Excerpts of Record
FICA:	Federal Insurance Contributions Act
FUTA:	Federal Unemployment Tax Act
IRS:	Internal Revenue Service

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STATEMENT OF JURISDICTION

Blue Lake Rancheria and Blue Lake Rancheria Economic Development Corporation (together, Blue Lake), a federally-recognized Indian tribe and its federally-chartered tribal corporation, appeal the January 8, 2010 judgment of the United States District Court for the Northern District of California (Judge Samuel Conti). (ER 1.)[1] Blue Lake brought this suit for refund against the United States, seeking to

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[1] "Doc." references are to documents contained in the record, as numbered by the Clerk of the District Court. "ER" references are to the pages of the appellants' excerpts of record. "Br." references are to the pages of appellants' brief.

recover tax paid under the Federal Unemployment Tax Act (FUTA) in the amount of $722,047 for 2003 and $1,283,892 for 2004, by Mainstay Business Solutions (Mainstay), a wholly-owned, unincorporated tribal enterprise. (Doc. 1.) Blue Lake filed an administrative claim for refund for Mainstay's 2004 tax year in January, 2005, and for its 2003 tax year in August, 2005. (*Id.*, Ex. A.) The Internal Revenue Service (IRS) disallowed the refund requests on April 24, 2008, and Blue Lake timely filed a refund suit on September 5, 2008, pursuant to § 6532(a)(1) of the Internal Code of 1986 (26 U.S.C.) (the Code or I.R.C.). (Doc. 1; ER 148-49.) The District Court had jurisdiction pursuant to I.R.C. § 7422(a), and 28 U.S.C. §§ 1346(a) and 1491.

On January 8, 2010, the District Court entered an order granting the Government's motion for summary judgment and denying that of Blue Lake. (ER 2-33.) The Clerk accordingly entered a separate judgment that same day. (ER 1.) Blue Lake filed a timely notice of appeal (ER 43-44) on March 5, 2010. *See* 28 U.S.C. § 2107(b); Fed. R. App. P. 4(a)(1)(B). This Court has jurisdiction over this appeal under 28 U.S.C. § 1291.

STATEMENT OF THE ISSUE

Mainstay, a wholly-owned, unincorporated division of Blue Lake, an Indian tribe, provides to small and medium-sized businesses a variety of administrative services, including the payment of wages to their employees. As the entity in control of the payment of wages, Mainstay, under I.R.C. § 3401(d)(1), was the statutory employer of these workers responsible for reporting and paying their employment taxes. The issue in this case is whether Mainstay's status as the statutory employer of its clients' workers under I.R.C. § 3401(d)(1) entitled it to avoid paying federal employment taxes for such workers, based on the tribal exemption set forth in I.R.C. § 3306(c)(7).

STATEMENT OF THE CASE

Blue Lake filed claims for refund for 2003 and 2004 relating to Mainstay, claiming that its clients' employees were also its employees pursuant to I.R.C. § 3401(d)(1), and that it was exempt from FUTA taxes pursuant to I.R.C. § 3306(c)(7). (Doc. 1, Ex. A.) The IRS contended that this exemption encompasses only services performed by workers in a common-law employment relationship with an Indian tribe and denied the claims. Blue Lake thereafter initiated the instant refund suit in the District Court. (Doc. 1; ER 148-49.) The case was

decided on cross-motions for summary judgment. (Docs. 26, 28.) The District Court entered an order, granting the Government's motion for summary judgment, and denying that of Blue Lake. (ER 2-33.) Judgment was entered accordingly (ER 1), and Blue Lake now appeals (ER 43-44).

STATEMENT OF FACTS

A. FUTA overview

The Internal Revenue Code imposes employment taxes on wages paid by an employer to its employees. Employment taxes include income tax withholding (Chapter 24, §§ 3401-3406), taxes imposed under the Federal Insurance Contributions Act (FICA) (Chapter 21, §§ 3103-3128) on the employee (§ 3101; the employee portion of FICA), which is required to be withheld by the employer (§ 3102), and the employer (§ 3111; the employer portion of FICA), and tax imposed on the employer under Federal Unemployment Tax Act (FUTA) (Chapter 23, §§ 3301-3311). The instant case addresses the interplay between FUTA and the income tax withholding provisions.

FUTA generally imposes an excise tax on every employer "with respect to having individuals in his employ," equal to a certain percentage of the wages paid during the calendar year "with respect to

employment." I.R.C. § 3301. Employment for FUTA purposes includes "any service, of whatever nature, performed after 1954 by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States . . . ." I.R.C. § 3306(c). FUTA, in turn, adopts the FICA definition of an "employee," as, *inter alia*, "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee." I.R.C. §§ 3121(d), 3306(i). As relevant to this case, FUTA excludes from its definition of employment "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 . . . ." I.R.C. § 3306(c)(7).

Chapter 24 of the Code, addressing "Collection of Income Tax at Source on Wages" provides that "[e]xcept as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary." I.R.C. § 3402. The Code generally defines "employer" for income tax withholding purposes as "the person for whom an individual performs

or performed any service, of whatever nature, as the employee of such person." I.R.C. § 3401(d). The Code, however, provides an exception to the general definition of employer in the income tax withholding context, stating 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." I.R.C. § 3401(d)(1). Section 3401(a), as relevant here, defines the term "wages" as "all remuneration . . . for services performed by an employee for his employer." The concept of an entity in control of the payment of wages within the meaning of I.R.C. § 3401(d)(1) being liable for the payment of tax has been extended to FICA and FUTA by case law. *See Otte v. United States*, 419 U.S. 43, 51 (1974); *Winstead v. United States*, 109 F.3d 989, 991 (4th Cir. 1997); *Southwest Rest. Sys., Inc. v. IRS*, 607 F.2d 1237, 1240 (9th Cir. 1979); *In re Armadillo Corp.*, 561 F.2d 1382, 1386 (10th Cir. 1977).

B. Mainstay's business operations

In May 2003, Blue Lake, a federally-recognized Indian tribe located primarily in Blue Lake, California, and consisting of approximately 53 members, formed Mainstay, a wholly-owned

unincorporated tribal enterprise. (ER 104-05.) Mainstay provides an array of administrative functions to small and medium-sized businesses, including payroll processing services, worker's compensation insurance, employee benefit plans, and human resource expertise. (*Id.*) According to Mainstay's Employee Handbook, it allows a client to "focus on its business" by removing administrative burdens from its shoulders. (Doc. 32-1 at 6.)

Mainstay accomplishes this end through the use of a business model commonly referred to as an "employee-leasing company" or a "professional employer organization." In short, after entering into an agreement with Mainstay, a client terminates its workforce, with Mainstay hiring the workers and leasing them back to the client for a fee. In this regard, under Mainstay's Standard Customer Agreement, Mainstay would "recruit, screen and hire employees for assignment at [client's] place of business in accordance with the job requirements and job descriptions provided by [client]." (ER 111.)

Despite the presence of Mainstay, the client continues to direct and control the details of the workers' performance of services. According to Mainstay's Standard Customer Agreement, the client "agrees to supervise the work of any Mainstay Business Solutions

employee assigned to the [client's] workplace" (ER 114), and "will exercise good judgment and management relating to the day-to-day supervision" of such workers (ER 112). As Mainstay's Employee Handbook explains, "[y]our day-to-day job duties, hours and activities will be directed by management at your worksite company. Other features of your employment including payroll and benefits, if applicable will be managed by Mainstay." (ER 75. *See also* Doc. 32-2 at 72.) As Mainstay's Management Guide states, "[a]lthough Mainstay will be integrated into areas involving employee services, your employees still work for your company and you still direct their day-to-day activities in the workplace." (Doc. 32-2 at 4.)

In its Employee Handbook, Mainstay identifies its primary responsibilities to its clients as "clarifying policies and procedures for employees, providing wages and benefit programs, assisting in worksite company safety compliance, . . . [and] assisting both employees and worksites with problem resolution." (ER 75.) In addition, according to a Standard Customer Agreement, Mainstay retains personnel files and payroll records for the workers, and contracts to "withhold, pay, and report all taxes and issue employee W-2 forms at the end of each year with respect to each of its employees

provided to Customer, as required by law." (ER 111.) Mainstay further agrees to maintain "Occupational Injury Indemnity and Medical Benefits" coverage for the workers, as well as "unemployment, general liability, and fidelity insurance." (ER 111-12.)

Mainstay's practice in the wake of a client agreement is to dispatch a member of its human resources staff to meet with workers and supervisors, and implement the new architecture. (ER 64-69.) According to the declaration of Mainstay's director of client services, in addition to distributing handbooks and guides, and having the workers fill out new-hire paperwork, Mainstay staff inform "the employees that their daily work activities would be directed by supervisors at the worksite, and that their wages, benefits, employment rules, and related policies would be directed by Mainstay." (ER 65.) In his declaration, Mainstay's chief executive officer during 2003 and 2004 stated that the human resources staff "were expected to inform employees that they should contact Mainstay's Human Resource Department regarding pay, benefits, and employment policies, and to inform supervisors that they should contact [the HR Department] regarding personnel issues, especially harassment complaints, and employee discipline and terminations decisions." (ER 106.) The Mainstay human resources

department periodically would follow up with the client's workforce, with the Mainstay Director of Client Services noting (in her declaration) that most "clients did not have sophisticated in-house Human Resource expertise." (ER 68.)

Although Mainstay claims it has "sole responsibility" for the hiring and firing of the client's once-and-future workers, the client could notify Mainstay if it "should decide it no longer wishes to accept the services of any particular" worker, pursuant to a Standard Customer Agreement. (ER 113, 125.) According to Mainstay's Management Guide, Mainstay is "available to discuss disciplinary procedures with you and an employee," and, as an outsider, is "able to offer objective advice." (Doc. 32-2 at 39.) Mainstay recognized, however, that "YOU – as the workplace manager – are making the judgment call as to whether or not disciplinary measures should be taken." (*Id.*) If necessary, Mainstay agreed that it would remove a fired worker from the workplace, according to its Standard Customer Agreement. (ER 113.) Mainstay's CEO stated in his declaration that, if "an employee was involuntarily terminated, Mainstay would attempt to place that employee with a leasing or temporary staffing agency client in the local community." (ER 106.)

Mainstay's practice is to send its clients an invoice for all wages to be paid in a pay period at least one day prior to the date of payroll delivery. (ER 107.) The record does not suggest that the amounts invoiced exclude employment taxes, including FUTA taxes, that Mainstay paid to the IRS relating to its clients' workers.

C. State administrative proceedings

The first legal proceeding addressing Mainstay's relationship to its clients' workers arose out of the California Unemployment Insurance Code (CUIC).[2] (ER 140-47.) Section 802 of the CUIC permits a state political subdivision or Indian tribe, "in lieu of the contributions required of the employers," to elect to finance unemployment benefit contributions to the state fund using a reimbursement financing method. (ER 145.) California assessed state unemployment taxes against Mainstay for 2003 and 2004, asserting that Mainstay was not eligible to use the reimbursement method for its clients' workers, a position that Mainstay challenged before the

[2] In order to provide an incentive for states to set up their own unemployment compensation programs, FUTA credits "against the tax imposed by section 3301 the amount of contributions paid by [the taxpayer] into an unemployment fund maintained . . . under the unemployment compensation law of a State." I.R.C. § 3302(a)(1).

California Unemployment Insurance Appeals Board (Appeals Board). (ER 140-47.)

The Appeals Board determined that California law would permit the use of the reimbursement financing method, because the CUIC definition of an employer would include Mainstay, even concerning the workers who were performing services for its clients. (ER 146.) As the Appeals Board observed, the CUIC generally follows the "common law rules applicable to the employer-employee relationship." (ER 144.) The CUIC, however, deviates from the common law view by expressly expanding its definition of employer to include a "temporary services employer" and "a leasing employer," pursuant to CUIC § 606.5(b), (c). (*Id.*) The Appeals Board concluded that, for purposes of California's unemployment law, "[a]lthough the actual services of Mainstay Business Solutions employees are services of individuals that work for third-party customers, they are employees of Mainstay under section 606.5 of the Code." (ER 145.)

D. Mainstay's claim for FUTA tax refunds

Mainstay reported and paid to the IRS FUTA taxes related to the wages it paid to its clients' workers in 2003 and 2004. (ER 107-08.) Mainstay filed administrative claims for refund (Form 843) with

respect to the FUTA tax payments for 2003 and 2004, asserting that it was exempt from FUTA taxes on the wages paid to its clients' workers, pursuant to I.R.C. § 3306(c)(7). (*Id.*) Blue Lake subsequently brought this action seeking a refund of FUTA taxes paid by Mainstay for tax years 2003 and 2004 in the total amount of $2,005,939, plus interest. (Doc. 1.) Mainstay based its refund claim on its status as a statutory employer under I.R.C. § 3401(d)(1), asserting that such status entitled it to the I.R.C. § 3306(c)(7) tribal exemption from FUTA taxes paid for its clients' workers.[3] (ER 149.)

The parties filed cross motions for summary judgment. (Doc. 26, Doc. 28.) Blue Lake argued in its motion for summary judgment that § 3306(c)(7) of the Code exempted it from FUTA tax on the wages it paid to workers performing services for its clients for two general reasons. (Doc. 28.) First, Blue Lake alleged that because Mainstay was in control of the payment of wages for each of its clients' workers, Mainstay was the employer of the workers for all of 2003 and 2004 for purposes of I.R.C. § 3401(d)(1). (*Id.* at 29-30.) Since Mainstay was the

[3] For purposes of its motion for summary judgment, the United States assumed *arguendo* that Mainstay constituted a statutory employer under I.R.C. § 3401(d)(1), based on the Government's position "that, as a matter of law, Mainstay is not exempt from FUTA by virtue of being a section 3401(d)(1) employer." (Doc. 26 at 3, n.1.)

I.R.C. § 3401(d)(1) employer, it was exempt from FUTA pursuant to I.R.C. § 3306(c)(7). (*Id.*) Second, Blue Lake contended that the workers at issue performed services in Mainstay's employ, since Mainstay "provided them with the opportunity to work" (*id.* at 16), thus qualifying Mainstay for the tribal exemption as their employer, or co-employer of their clients' workers (*id.* at 20-24, 26-29).

In its motion, the United States acknowledged that a wholly-owned enterprise of an Indian tribe, like Mainstay, is eligible to claim an exemption from FUTA taxes related to wages paid to its common-law employees. (Doc. 26 at 12-15.) The Government explained that Blue Lake's reliance on I.R.C. § 3401(d)(1) was misplaced because the "statutory language and conference report make clear that the exception with respect to the definition of 'employer' where a third-party controls the payment of wages relates only to the responsibilities to withhold, to report, and to pay the withholding tax." (*Id.* at 16.) Thus, even though an I.R.C. § 3401(d)(1) employer is liable for payment of the tax, exceptions from the definitions of "wages" or "employment," as defined by the income tax withholding, FICA, and FUTA statutes, are determined with regard to the common-law employer. The Government further explained that, because the clients, not Mainstay,

controlled the workers' job performances, the workers were not common-law employees of Mainstay, and Mainstay could not claim the FUTA tribal exemption for wages that it paid to these workers. (*Id.* at 23. *See also* Doc. 40 at 28-30.)

The District Court granted the Government's motion for summary judgment. (ER 33.) Agreeing with the Government's reading of the statutory provisions, the court reasoned that the I.R.C. § 3401(d)(1) statutory employer is not the relevant employer for defining "employment" under FUTA. (ER 17-21.) The court observed that the text and structure of FUTA, along with several administrative interpretations, premised FUTA liability on a common-law employment relationship. (ER 16.) The court further noted that Blue Lake's reading of the statute had a high potential for abuse, allowing non-tribal employers to gain the benefits of a tax exemption intended only for Indian tribes. (ER 24.)

The District Court then determined that Mainstay was not a common-law employer of its clients' workers because it did not direct and control the workers' service, observing that the clients themselves set and directed the duties, hours, and activities of the workers. (ER 28.) The court also rejected Mainstay's argument that its hiring and

termination rights, as well as its general oversight of safety and discipline, amounted to a true common-law employment relationship with the workers. (ER 29.) According to the court, Mainstay "did not fundamentally affect the day-to-day provision of services that [its] employees provided." (ER 31.)[4] This appeal followed.

SUMMARY OF ARGUMENT

Section 3301 of the Internal Revenue Code imposes a tax "on every employer (as defined in section 3306(a)) for each calendar year," "with respect to having individuals in his employ," equal to a certain percentage "of the total wages (as defined in section 3306(b)) paid by him during the calendar year (or portion of the calendar year) with respect to employment (as defined in section 3306(c))." FUTA excludes from the scope of "employment" certain categories of service, *see* I.R.C. § 3306(c)(1)-(21), which consequently exempts such services from the reach of FUTA liability. As relevant to the instant case, FUTA exempts "service performed in the employ of a State, or any political subdivision thereof, or in the employ of an Indian tribe, or any

[4] The court also rejected Blue Lake's suggestion that the California Appeals Board ruling required a finding that Mainstay was an employer for FUTA purposes, noting that the decision rested primarily on an interpretation of CUIC § 606.5, and did not address the dispositive issue, *viz.*, whether Mainstay was the common-law employer of the leased employees. (ER 31-32.)

instrumentality of any one or more of the foregoing which is wholly owned by one or more States or political subdivisions or Indian tribes . . . ." I.R.C. § 3306(c)(7). These exemptions from FUTA liability come with a built-in limitation, however. In I.R.C. § 3306(c), "employment" for FUTA purposes is defined with reference to a common-law employment relationship, and thus the exemptions only apply in the context of a common-law employment relationship.

1. In this case, Blue Lake seeks a refund of FUTA taxes for 2003 and 2004 on behalf of its wholly-owned, unincorporated, enterprise, Mainstay, which provides administrative services, including payroll and tax withholding services, for a number of businesses. As the entity in charge of the payment of wages for its clients' workers, Mainstay constitutes a statutory employer under I.R.C. § 3401(d)(1) for purposes of withholding federal income tax for its clients' employees. Blue Lake argues that Mainstay's position as a statutory employer, coupled with its nature as a tribal enterprise, entitles it to the tribal exemption from FUTA tax liability for its clients' workers.

Blue Lake's refund claim falls short. Although the courts have held that a statutory employer for income tax withholding purposes also qualifies as an employer for FUTA purposes, the exemptions from

FUTA liability are not defined in relation to the FUTA employer. The exemptions, rather are related to the FUTA definition of employment, which requires a common-law employment relationship. Mainstay's status as a statutory employer, therefore, does not entitle it to claim the tribal exemption.

2. Blue Lake fails to refute this conclusion. Blue Lake relies on similar phrases ("in the employ") in I.R.C. § 3301 and I.R.C. § 3306(c)(7), contending that they must be interpreted consistently and encompass a statutory employer. Blue Lake also argues that failure to interpret "in the employ" consistently creates a gap between tax liability and exemption from liability under FUTA. Blue Lake finally asserts that reading "in the employ" to mean "employee" frustrates a Congressional decision and renders the phrase surplusage. To support these points, Blue Lake invokes the interpretive canon that statutes enacted for the benefit of Indians must be construed in their favor.

Although identical words in different parts of a statute are generally intended to have the same meaning, this yields to the controlling force of the statutory context. Here the context is dispositive – the phrase "individuals in his employ" as used in I.R.C. § 3301 encompasses a statutory-employer relationship, while, as

explained above, the phrase as used in I.R.C. § 3306(c)(7) is necessarily limited to common-law employment relationships, as the tribal exemption is an exception to I.R.C. § 3306(c). Moreover, there is no disconnect between the FUTA liability and exemptions; a tribe is entitled to the I.R.C. § 3306(c)(7) exemption for its own common-law employees – that does not mean that it is entitled to the exemption for the employees of others that are not its common-law employees. Blue Lake finally fails to show that the District Court's interpretation of "in the employ" as used in I.R.C. § 3306(c)(7) frustrates any considered Congressional intent or renders the words meaningless.

The interpretive canon applicable to Indian law cannot salvage these arguments. This presumption applies only in cases of ambiguity, and, relating to tax exemptions, only where a clear exemption exists. In this case, however, the FUTA framework and language compels the conclusion that I.R.C. § 3306(c)(7) is limited to common-law employment, and Blue Lake fails to identify an explicit exemption related to statutory employers.

3. Given that a statutory-employer relationship is insufficient to claim the I.R.C. § 3306(c)(7) exemption, Blue Lake, therefore, must demonstrate that Mainstay acted as a common-law employer for its

clients' workers. Blue Lake cannot do so. As the District Court held, although the contracts between Mainstay and its clients purported to give Mainstay general oversight rights, these did not establish Mainstay's right to control and direct the means and manners of the workers' performance. Mainstay's own documents rather show that the clients themselves retained the right to control their workers at their own workplaces. The other employment factors on which Blue Lake relies merely establish that Mainstay provided administrative services to its clients, not that it was a common-law employer.

4. Finally, Blue Lake asserts that the District Court erred by failing to follow the decision of the California Unemployment Insurance Appeals Board, and by overstating the potential for abuse from Blue Lake's reading of the statute. Neither is correct. The Appeals Board's ruling does not require a different result, given that its decision was premised on provisions of California state law that are not relevant to the instant case. Moreover, Blue Lake's interpretation would allow employers who are exempt from FUTA liability to auction off their exemption to non-exempt entities, opening a wide door to abuse.

The judgment of the District Court is correct and should be affirmed.

ARGUMENT

The District Court correctly held that Mainstay was not entitled to claim the tribal exemption from FUTA liability set forth in I.R.C. § 3306(c)(7)

Standard of review

This Court reviews "a district court's decision on cross-motions for summary judgment de novo." *See Avery v. First Resol. Mgmt. Corp.*, 568 F.3d 1018, 1021 (9th Cir. 2009).

A. Introduction to statutory schemes

1. Internal Revenue Code provisions relating to FUTA tax

Section 3301 of the Internal Revenue Code imposes a tax "on every employer (as defined in section 3306(a)) for each calendar year," "with respect to having individuals in his employ," equal to a certain percentage "of the total wages (as defined in section 3306(b)) paid by him during the calendar year (or portion of the calendar year) with respect to employment (as defined in section 3306(c))." As the District Court observed (ER 13), "FUTA liability depends upon a circuit of overlapping definitions, and it is necessary to examine each term in order to understand how the tribal exception operates." In particular, FUTA liability hinges on the definitions of "employment," "wages," and

"employer," which are used in I.R.C. § 3301 and defined in I.R.C. § 3306.

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.[5] Employment for FUTA purposes encompasses "any service, of whatever nature, performed after 1954 by an employee for the person employing him, irrespective of the citizenship of either, (i) within the United States . . . ." I.R.C. § 3306(c). This definition, in turn, relies on another defined term, "employee," which FUTA defines by reference to the FICA – "the term 'employee' has the meaning assigned to such term by section 3121(d)." I.R.C. § 3306(i). Section 3121(d) provides that the term "employee" means "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee." Combining these two definitions, employment for FUTA purposes includes any service performed by an individual pursuant to a common-law employment

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[5] The District Court apparently overlooked the presence of "employment" in I.R.C. § 3301, stating that "FUTA's liability provision, § 3301, does not directly use the term 'employment.'" (ER 13.) The court, however, nonetheless explored the significant implications of this term, since it correctly recognized that "employment" is incorporated into the definitions of both "wages" and "employer." *See* I.R.C. §§ 3301, 3306(a), (b).

relationship.[6] I.R.C. § 3306(c). The primacy of the common-law employment relationship is also infused in the other terms-of-art found in the FUTA liability provision, as both "wages" and "employer" incorporate the definition of employment in their own definitions. *See* I.R.C. § 3306(b) ("wages" defined as "remuneration for employment."); I.R.C. § 3306(a) ("employer" defined as any person: (i) who has paid wages of $1,500 or more in a calendar year, or (ii) who, "on each of some 20 days during the calendar year," employed at least one individual "in employment" for some portion of the day.)

FUTA excludes from the scope of "employment" certain categories of service, *see* I.R.C. § 3306(c)(1)-(21), and, accordingly, exempts such services from the reach of FUTA liability. As relevant to this case, FUTA exempts "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 . . . ." I.R.C. § 3306(c)(7). Given that this provision merely carves out an

[6] As will be discussed in greater detail *infra*, "such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished." 26 C.F.R. (Treas. Reg.) § 31.3306(i)-1(b).

exemption from the general FUTA definition of employment, its benefits extend to the limits of that definition, and no further. Eligibility for the tribal exemption from FUTA liability, therefore, requires a common-law employment relationship with an Indian tribe.

2. Internal Revenue Code provisions addressing collection of income taxes from wages

Section 3402 of the Code states that "[e]xcept as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary."[7] For income tax withholding purposes, the term "employer" encompasses "the person for whom an individual performs or performed any service of whatever nature, as the employee of such person." I.R.C. § 3401(d). The definition goes on to state, however, 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))

[7] As will be discussed in greater detail below, chapter 24, I.R.C. § 3401, *et seq.*, only addresses withholding of income taxes. The Supreme Court and Circuit Courts of Appeals have subsequently expanded chapter 24 to apply to FICA and FUTA taxes as well. *See, e.g., Otte v. United States*, 419 U.S. 43 (1974); *Southwest Rest. Sys., Inc. v. IRS*, 607 F.2d 1237, 1240 (9th Cir. 1979); *In re Armadillo Corp.*, 561 F.2d 1382, 1386 (10th Cir. 1977).

means the person having control of the payment of such wages." I.R.C. § 3401(d)(1).[8]

The legislative history of this provision indicates that Congress was concerned about "certain special cases, such as the . . . case of the person making payment of wages in situations where the wage payments are not under the control of the person for whom the services are or were performed, as, for instance, in the case of certain types of pension payments." H.R. Conf. Rep. No. 78-510, at 30-31 (1943). The Conference report went on to observe that "[t]he House bill provided for these cases by an exception to the general definition of the term 'employer' which provided that if the wages are paid by a person other than the person for whom the services are or were performed, the term 'employer' means the person paying such wages," and that "[t]he Senate has restated the exception in order to make clear that it is designed solely to meet unusual situations and is not intended as a departure from the basic purpose to centralize responsibility for withholding, returning, and paying the tax and furnishing receipts." *Id.* As the Supreme Court observed, this definition of employer

[8] As relevant here, I.R.C. § 3401(a) defines the term "wages" as "all remuneration . . . for services performed by an employee for his employer."

"obviously was intended to place responsibility for withholding [of income taxes] at the point of control." *Otte v. United States*, 419 U.S. 43, 51 (1974).

In *Otte*, the Supreme Court held that an I.R.C. § 3401 employer is liable not only for withholding and paying over income taxes, as expressly provided by the Code, but also for withholding and paying FICA taxes, as the term employer "is not to be given a narrower construction for FICA withholding than for income tax withholding." *Otte*, 419 U.S. at 51. "[S]ince *Otte*, courts have uniformly applied the definition of section 3401(d)(1) to FUTA." *Winstead v. United States*, 109 F.3d 989, 991 (4th Cir. 1997). *See also Southwest Rest. Sys., Inc. v. IRS*, 607 F.2d 1237, 1240 (9th Cir. 1979); *In re Armadillo Corp.*, 561 F.2d 1382, 1386 (10th Cir. 1977). As this Court has explained, "there is nothing inequitable in the placing of such a burden upon a corporation which voluntarily places itself in the position of handling the wages and reporting the amounts due under the taxing statutes . . . ." *Southwest Rest.*, 607 F.2d at 1240. Indeed,"if the entity with control of the payment of wages is not the entity liable for both the Employee and Employer Portions of FICA taxes and the FUTA taxes, then it might be possible for an employer to avoid liability for its employment tax

contributions by assigning the duty of payment to an independent third-party. The employer could escape liability by claiming it was not the party paying the wages, whereas the third-party could escape liability by arguing that no employment relationship existed." *In re Terex Corp.*, 93 B.R. 127, 130 (Bankr. N.D. Ohio 1988), *discussing In re Armadillo Corp.*, 410 F.Supp. 407, 412 (D. Colo. 1976), *aff'd*, 561 F.2d 1382 (10th Cir. 1977).

B. A statutory employer under I.R.C. § 3401(d)(1) is not entitled to claim the tribal exemption from FUTA liability set forth in I.R.C. § 3306(c)(7)

1. Although a statutory employer, such as Mainstay[9], is considered an employer for purposes of the tax liability imposed by I.R.C. § 3301, such an employer is ineligible to claim the tribal exemption set forth in I.R.C. § 3306(c)(7). *Otte* and its progeny have extended responsibility for FICA and FUTA taxes to statutory employers, given that they are in the best position to account for and pay over such tax. But this expansion of who is responsible for FUTA taxes does not alter the fundamental nature of FUTA liability. As explained above, FUTA liability is built on "employment," I.R.C.

[9] As explained in n.3, *supra*, the United States assumed, for purposes of its summary judgment motion, that Mainstay is a statutory employer under I.R.C. § 3401 of its clients' workers, as Blue Lake asserted in its complaint (ER 149).

§ 3301, which itself is premised on a common-law employment relationship. The tribal exemption from FUTA liability, like all the exemptions listed in I.R.C. § 3306(c)(1)-(21), is an exception from this definition of employment, and thus is restricted to the same scope as that underlying provision. The fruits of I.R.C. § 3306(c)(7) accordingly are restricted to a common-law employment relationship. In short, the tribal exemption does not relate to who is responsible for FUTA taxes, and, thus, status as a statutory employer does not suffice to earn its benefits. *Cencast Servs., L.P. v. United States*, 62 Fed. Cl. 159, 180 (Fed. Cl. 2004) ("It is true that plaintiffs, as employers who pay the [workers'] wages, are best situated to properly account for and pay FICA and FUTA taxes to the government. But that does not mean that they must be considered the [workers'] employers for purposes of calculating the FICA and FUTA wage bases.").

2. The view that FUTA liability, and any exemption thereto, require a common-law employment relationship is confirmed by the IRS' long-standing interpretations in its Revenue Rulings. *See* Rev. Rul. 69-316, 1969-1 C.B. 263; Rev. Rul. 57-145, 1957-1 C.B. 332; Rev. Rul. 54-471, 1954-2 C.B. 348. As this Court has recently noted, "Revenue Rulings are entitled to at least *Skidmore* deference as they

constitute 'a body of experience and informed judgment to which courts and litigants may properly resort for guidance.'" *Bluetooth SIG Inc. v. United States*, --- F.3d ---, 2010 WL 2681237, at *4 (9th Cir. July 8, 2010), *quoting Texaco Inc. v. United States*, 528 F.3d 703, 711 (9th Cir. 2008). The Supreme Court agrees with this view, observing that an "agency's policy statements, embodied in its compliance manual and internal directives, interpret not only the regulations but also the statute itself. Assuming these interpretive statements are not entitled to full *Chevron* deference, they do reflect 'a body of experience and informed judgment to which courts and litigants may properly resort for guidance' . . . [and] are entitled to a 'measure of respect' under the less deferential *Skidmore* standard." *Fed. Express Corp. v. Holowecki*, 552 U.S. 389, 399 (2008) (internal citations omitted). The Supreme Court has explained that the deference afforded in such an instance depends on the "thoroughness evident in [the agency's consideration], the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it the power to persuade . . . ." *United States v. Mead Corp.*, 533 U.S. 218, 228 (2001), *citing Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944).

The IRS has consistently held that, for "purposes of the Federal employment taxes the usual common law rules ordinarily apply in determining whether the employer-employee relationship exists and, if so, who is the employer." Rev. Rul. 69-316, 1969-1 C.B. 263. *See also* Rev. Rul. 54-471, 1954-2 C.B. 348; Rev. Rul. 57-145, 1957-1 C.B. 332. The IRS has expressly distinguished between the roles of the common-law employer and the statutory employer under I.R.C. § 3401(d) in this context:

> Thus, when *Y* has control of the payment of wages for services performed by an employee of a subsidiary, *Y* is the 'employer' of that employee for purposes of income tax withholding even though the subsidiary is the employer with respect to the wages for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Act.

Rev. Rul. 69-316, 1969-1 C.B. 263. *See also* Rev. Rul. 57-145, 1957-1 C.B. 332 (common-law employer found to be employer for unemployment tax liability, instead of the architecture firm "responsible for the withholding of Federal income tax from such wages.")

In other words, for determining FUTA liability, and exceptions thereto, the Revenue Rulings look to whether "a common law relationship of employer and employee existed . . . ." Rev. Rul. 54-471,

1954-2 C.B. 348. The IRS' position is well-illustrated in Rev. Rul. 54-471, 1954-2 C.B. 348, in which the IRS encountered a state-owned citrus commission that controlled the services of certain demonstrators, which an advertising agency had recruited and paid. *Id.* Although the IRS noted that the advertising agency was the employer for withholding purposes, it nonetheless looked to the common-law employer, the citrus commission, for the employment tax liability, determining that the demonstrators' services "are excepted from 'employment' . . ., and liability for the taxes imposed by the [a]cts is not incurred by the commission." In short, the long-held, consistent position of the IRS confirms that employment tax liability, and any exceptions thereto, are based on the common-law employment relationship.

Although, as Blue Lake points out (Br. 51), these Revenue Rulings preceded the Supreme Court's decision in *Otte* that I.R.C. § 3401(d)(1) applies in the context of FICA and FUTA, the principle articulated in them remains viable. As an initial matter, "[t]reasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect

of law." *United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 219 (2001) (discussing long-standing Revenue Rulings and Treasury Regulations interpreting FICA and FUTA) (internal citations omitted). As Congress has made no pertinent changes to I.R.C. § 3301 or I.R.C. § 3401 in the wake of these Revenue Rulings, *see Cencast*, 62 Fed. Cl. at 173 ("the statutory language of the employment tax provisions has, in relevant part, remained unchanged"), these Revenue Rulings "are deemed to have received congressional approval." *Cleveland Indians*, 532 U.S. at 219.

Moreover, the continuing viability of the Revenue Rulings is confirmed by the decision of the Court of Federal Claims in *Cencast*, in which that Court considered whether a statutory employer under I.R.C. § 3401(d)(1) constituted an employer for purposes of calculating wages under I.R.C. § 3306(b)(1). 62 Fed. Cl. at 163-64. As the District Court in the instant case explained, although *Cencast* "does not specifically address the issue of whether a statutory or common law employer is the relevant employer for applying the § 3306(c) exemptions," it is relevant nonetheless "because of the role that 'employment' plays in defining 'wages.'" (ER 21.) Reviewing the same Revenue Rulings discussed above, the Court of Federal Claims in

Cencast accorded substantial deference to the IRS' position "maintaining the common law employer as the necessary referent for calculating employment tax liabilities," 62 Fed. Cl. at 174, on the ground that the Revenue Rulings constituted "correct and consistent interpretations of the Internal Revenue Code," 62 Fed. Cl. at 173.

The Supreme Court's holding in *Otte*, and its progeny, did not compel a different result, according to the Court of Federal Claims. *See Cencast*, 62 Fed. Cl. at 179-83. Relying on *Otte*, the plaintiffs in *Cencast* argued that "it makes sense that the employer paying wages be considered the employer for purposes of calculating FICA and FUTA wage bases." 62 Fed. Cl. at 180. The Court of Federal Claims responded that the "cases following *Otte* do not, however, support the contention that, as a result [of *Otte*], the statutory employer is considered to have paid the employees's wages for the purposes of calculating the employees' FICA and FUTA wage bases." *Id.* "What *Otte*, *Armadillo*, and the subsequent cases fail to do, however, is address the issue of how FICA and FUTA wage bases are to be calculated." *Id.* at 181. In short, *Otte* and its progeny do not discuss, much less support, the argument that a statutory employer suffices for the FUTA definition of "employment," the predicate for both "wages" in

Cencast and the tribal exemption here. The court, "persuaded that the IRS's interpretation is correct as a matter of law," therefore, accorded substantial deference to the "long-standing, uniform administrative practice of interpreting the relevant Code provisions" contained in the Revenue Rulings – FUTA liability, and any exceptions thereto, require a common-law employment relationship. *Id*. at 184.

In its brief (Br. 26-28), Blue Lake asserts that the *Cencast* decision is inapposite because it deals with wages, "an area that section 3401 explicitly excludes from its coverage," and because it does not specifically address I.R.C. § 3306(c)(7). Neither point hits its mark. *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. The fact that *Cencast* does not deal with § 3306(c)(7) does not eliminate its relevance for determining the scope of FUTA employment, and, accordingly, the scope of the FUTA exemptions.[10]

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[10] Blue Lake argues (Br. 30) that the IRS "itself has, in the past, adopted the interpretation that the Tribe now advances," relying (Br. 30, n.5) on I.R.S. Priv. Ltr. Rul. 9237023. As an initial matter, "a written determination may not be used or cited as precedent." I.R.C. § 6110(k)(3). In any event, I.R.S. Priv. Ltr. Rul. 9237023 does not conflict with the IRS' long-standing position described above, but notes that *Otte* and its progeny "extend[] the principles of section 3401(d) for

(continued...)

3. Blue Lake attempts to sidestep this result by ignoring the terms used in I.R.C. § 3301, including employment, which indicate that FUTA liability is tethered to a common-law employment relationship. Instead, Blue Lake argues that Mainstay's status as a statutory employer was sufficient for it to claim the tribal exemption because both I.R.C. § 3301 and I.R.C. § 3306(c)(7) use the phrase "in the employ" (Br. 34-41), which, according to Blue Lake, must be interpreted consistently and refer to the same entity.[11] Blue Lake argues that failure to interpret "in the employ" consistently results in a "disconnect between tax liability and exemption from liability under FUTA." (Br. 36-37.) Blue Lake also argues that some Congressional purpose must lie behind its decision to use "in the employ," rather than "employee," and, thus, "in the employ" must be interpreted differently from employee. (Br. 38-40.) Otherwise, according to Blue Lake, the

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[10] (...continued)
purposes of employer FICA and FUTA." As explained above, this is not a point of contention. Rather the question is whether a statutory employer relationship suffices to satisfy the FUTA definition of "employment." Although the letter ruling later sets forth the terms of I.R.C. § 3306(c)(7), it does not undertake to analyze whether the I.R.C. § 3401(d) employer is entitled to the exemption contained therein. I.R.S. Priv. Ltr. Rul. 9237023.

[11] The phrase in I.R.C. § 3301 is actually "in his employ."

term is rendered mere surplusage. (Br. 40.) None of Blue Lake's contentions hold water.

Blue Lake's argument stumbles out of the gate because of its improperly blinkered view of I.R.C. § 3301. As the Supreme Court and this Court have repeatedly held, a statute must be read as a whole with meaning given to each word or phrase. *See e.g., Samantar v. Yousuf*, 130 S. Ct. 2278, 2289 (2010) ("In sum, '[w]e do not . . . construe statutory phrases in isolation; we read statutes as a whole.'"), *quoting United States v. Morton*, 467 U.S. 822, 828 (1984); *Milner v. United States Dep't of Navy*, 575 F.3d 959, 966 (9th Cir. 2009) ("Under accepted canons of statutory interpretation, we must interpret statutes as a whole, giving effect to each word and making every effort not to interpret a provision in a manner that renders other provisions of the same statute inconsistent, meaningless or superfluous."), *quoting Boise Cascade Corp. v. EPA*, 942 F.2d 1427, 1432 (9th Cir. 1991)). Blue Lake concentrates its attention solely on Mainstay's status as a statutory employer, and fails to pay any heed to the other defined terms in I.R.C. § 3301, which place the common-law employment relationship at the core of FUTA liability, and any exemptions thereto. Given Blue Lake's failure to account for the necessary terms used to

define FUTA liability, and the exemptions to it, Blue Lake's analysis is doomed from the start.

Moreover, although Blue Lake is correct 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,'" *Sorenson v. Sec'y of Treasury*, 475 U.S. 851, 860 (1986), *quoting Helvering v. Stockholms Enskilda Bank*, 293 U.S. 84, 87 (1934), "the presumption readily yields to the controlling force of the circumstance that the words, though in the same act, are found in such dissimilar connections as to warrant the conclusion that they were employed in the different parts of the act with different intent." *Stockholms Enskilda Bank*, 293 U.S. at 87. As the Supreme Court specifically observed in the FICA context:

> Although we generally presume that "identical words used in different parts of the same act are intended to have the same meaning," *Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433, 52 S.Ct. 607, 76 L.Ed. 1204 (1932), the presumption "is not rigid," and "the meaning [of the same words] well may vary to meet the purposes of the law," *ibid.*

Cleveland Indians, 532 U.S. at 213. "There is, then, no 'effectively irrebuttable' presumption that the same defined term in different provisions of the same statute must be 'interpreted identically.'

Context counts." *Envtl. Def. v. Duke Energy Corp.*, 549 U.S. 561, 575-76 (2007) (internal citations omitted).

Blue Lake essentially argues that because both I.R.C. § 3301 and § 3306(c)(7) each include the descriptive phrase "in the employ," both provisions must have the same meaning. This does not follow. In fact, the relevant contexts in which this common phrase is used prohibit such a reading. Under I.R.C. § 3301, the phrase "individuals in his employ" encompasses a statutory-employer relationship, since *Otte* and its progeny establish that a statutory employer is liable under I.R.C. § 3301. The context in which this phrase is located in I.R.C. § 3306(c)(7) is markedly different. Although § 3306(c)(7) speaks of "services performed . . . in the employ of an Indian tribe," as explained above, I.R.C. § 3306(c) necessarily limits the meaning of the phrase to services performed in the employ of an Indian tribe pursuant to a

common-law employment relationship.[12] Context matters, and, here, it disposes of Blue Lake's argument.

Blue Lake also shoots wide of the mark when it argues that any discrepancy in the interpretation of this phrase creates a problematic "disconnect between tax liability and exemption from liability under FUTA." (Br. 44-45.) A tribe's entitlement to the I.R.C. § 3306(c)(7) exemption for its own employees does not mean that it is entitled to the exemption regardless of the context. As this Court has noted, "there is nothing inequitable in the placing of such a burden upon a corporation which voluntarily places itself in the position of handling the wages and reporting the amounts due under the taxing statutes . . . ." *Southwest Rest.*, 607 F.2d at 1240. "[I]f the entity with control of the payment of wages is not the entity liable for both the Employee and Employer Portions of FICA taxes and the FUTA taxes, then it might be possible for an employer to avoid liability for its employment tax

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[12] Taking a slightly different tack, Blue Lake also argues that the plain language of "in the employ" in I.R.C. § 3306(c)(7) merely means to hire, and thus its clients' workers were in its employ for purposes of the exemption because, after its clients fired these workers, Blue Lake hired them. (Br. 44-45.) Once again, Blue Lake ignores the statutory context in which I.R.C. § 3306(c)(7) is placed, *viz.*, as an exception to the definition of employment set forth in I.R.C. § 3306(c), which requires an actual common-law employment relationship, not merely the formalities.

contributions by assigning the duty of payment to an independent third-party. The employer could escape liability by claiming it was not the party paying the wages, whereas the third-party could escape liability by arguing that no employment relationship existed." *Terex Corp.*, 93 B.R. at 130.

Nor, as a practical matter, is it obvious that the FUTA structure imposes any sort of untoward liability on Mainstay. Mainstay's practice is to send its clients an invoice for all wages to be paid in a pay period at least one day prior to the date of payroll delivery. (Doc. 31 at 4.) There 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.

Blue Lake also argues that Congress must have intended "in the employ" to have a different meaning than employee, (Br. 38-41), but this is similarly unavailing. Blue Lake offers no real reason that "in the employ" should not be interpreted as synonymous with employee, but merely notes (Br. 39, n. 9) that a Fifth Circuit case, *Independent Petroleum Corp. v. Fly*, 141 F.2d 189, 190 (5th Cir. 1944), long-ago determined that some daylight might exist between the terms. In *Fly*, the Fifth Circuit ruled that a corporate officer who performed no work

for a corporation could not be considered an individual "in the employ" of that corporation for purposes of an additional tax under the Social Security Act. 141 F.2d at 191. As the District Court noted here (ER 22), although "the phrase 'in the employ' may be broader than the term 'employee,' [*Fly*] does not suggest that the phrase extends beyond common law employment relationships." In short, this argument amounts to a distinction with no difference.[13]

Nor does the District Court's interpretation of I.R.C. § 3306(c)(7) render the words "in the employ" mere surplusage, as Blue Lake suggests. (Br. 40.) As detailed above, both uses of "in the employ" have meaning in the contexts of I.R.C. § 3301 and I.R.C. § 3306(c)(7).

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[13] Even if Blue Lake's argument that the two phrases should have the same meaning is accepted, it does not follow that both include statutory employers. On the contrary, both should be understood as being restricted to the common-law understanding of employment. This is because a statutory employer, such as Mainstay, is only treated as having its client's employees "in his employ" for purposes of I.R.C. § 3301 because *Otte* and its progeny provide that the exception contained in I.R.C. § 3401 also applies to FICA and FUTA. But the fact that this exception has been construed to apply to FICA and FUTA does not change the definition of the phrases in those provisions. In other words, if one considers the exception contained in I.R.C. § 3401 to be grafted on to the unemployment provisions, it is grafted only on I.R.C. § 3301, as that is the provision that concerns responsibility for paying the unemployment tax. If one does not consider the exception to be grafted on to the unemployment provisions, then those provisions retain their usual understanding, *to wit,* as encompassing the common-law understanding of employment.

In its brief, Blue Lake concedes that the District Court's interpretation does accord a meaning to the phrases (Br. 39-40), but it objects to that meaning. The fact that the court failed to adopt Blue Lake's preferred interpretation certainly does not render the words at issue meaningless or superfluous.

4. In an attempt to bolster the arguments discussed above, Blue Lake turns to the canon of statutory construction that statutes enacted for the benefit of Indian tribes are to be construed liberally in favor of Indians, and contends that this interpretive canon applies in the instant case. (Br. 19-22, 31-34, 42-43.) This argument, however, provides little succor.

The Supreme Court has stated, "statutes are to be construed liberally in favor of the Indians, with ambiguous provisions interpreted to their benefit." *Montana v. Blackfeet Tribe of Indians*, 471 U.S. 759, 766 (1985). This Court has explained further:

> This presumption is subject to two implicit limitations. First, the presumption applies only to federal statutes that are "passed for the benefits of dependent Indian tribes." . . . Second, ambiguity is a prerequisite for any application of the *Blackfeet* presumption.

Artichoke Joe's Cal. Grand Casino v. Norton, 353 F.3d 712, 729 (9th Cir. 2003) (internal citations omitted). "Although statutory

ambiguities in legislation enacted for the benefit of Indians should be resolved in their favor, this presumption 'does not permit reliance on ambiguities that do not exist; nor does it permit disregard of the clearly expressed intent of Congress.'" *Spokane Indian Tribe v. United States*, 972 F.2d 1090, 1094 (9th Cir. 1992), *quoting South Carolina v. Catawba Indian Tribe, Inc.*, 476 U.S. 498, 506 (1986). Moreover, "[w]hile this court has recognized this canon of construction, it has also declined to apply it in light of competing deference given to an agency charged with the statute's administration." *Haynes v. United States*, 891 F.2d 235, 239 (9th Cir. 1989) (citations omitted). This Court has also stated that "when reviewing a claim for federal tax exemption, we do not engage the canon of construction favoring the Indians unless express exemptive language is first found in the text of the statute . . . [o]nly if such language exists, do we consider whether it could be 'reasonably construed' to support the claimed exemption." *Ramsey v. United States*, 302 F.3d 1074, 1079 (9th Cir. 2002).

In this case, the District Court properly found no ambiguities in the FUTA liability provisions that would require application of the tribal presumption. Blue Lake attempts to read in ambiguity, but, as detailed before, the text and defined terms of the FUTA liability

provision, which require the existence of a common-law employment relationship for any exemption, rebut any alleged ambiguity. Recourse to the presumption thus is unnecessary. *See Spokane Indian Tribe*, 972 F.2d at 1094 (tribal presumption does not permit reliance on ambiguities that do not exist).

Moreover, Blue Lake is attempting to add an exemption in the absence of express exemptive language. When Congress amended I.R.C. § 3306(c)(7) to include Indian tribes, it recognized that they were entitled to the same benefit as state governments, *viz.*, an exemption from the FUTA liability for their common-law employees. Blue Lake offers no support whatsoever for the suggestion that Congress intended to grant an exemption for tribes whenever it constitutes a statutory employer under I.R.C. § 3401(d)(1), and the District Court properly rejected the invitation to add such an exemption itself. Since there is no express exemptive language relating to statutory employers, the tribal presumption should not be consulted. *Ramsey*, 302 F.3d at 1079.

Finally, this Court has "declined to apply [the presumption] in light of competing deference give to an agency charged with the statute's administration." *Haynes*, 891 F.2d at 239. As explained previously, the long-standing, consistent interpretation of the IRS

establishes that FUTA liability, and any exemptions thereto, require a common-law employment relationship. *See Cencast*, 62 Fed. Cl. 183-84. *See also* Rev. Rul. 69-316, 1969-1 C.B. 263; Rev. Rul. 57-145, 1957-1 C.B. 332; Rev. Rul. 54-471, 1954-2 C.B. 348. The tribal presumption, therefore, should not be applied given the deference due this interpretation.

C. Mainstay's tribal exemption from FUTA taxes did not extend to its clients' workers because it was not the common-law employer of those workers as is required for the exemption to apply

As an entity's status as a statutory employer does not suffice for purposes of the tribal exemption, Blue Lake must establish that Mainstay acted as the common-law employer of its clients' workers to qualify for the exemption. In its brief, Blue Lake points to Mainstay's alleged right to control the means and manners of work performance, its hiring and termination rights, its payment of the workers' wages, and its provision of their employee benefits, as evidence of a common-law employment relationship with the workers. (Br. 58.) Furthermore, Blue Lake contends that the District Court erred by paying undue heed to the right to control the details of the workers' job performance, and, that, in any event, Mainstay possessed the necessary right to control, even if it did not exercise it. (Br. 59.) As the District Court determined

(ER 27-31), the evidence showed that Mainstay was not a common-law employer.

The existence of an employer-employee relationship generally turns on a number of factors, including: "(1) the right to control the details of the work; (2) furnishing of tools and the work place; (3) withholding of taxes, workmen's compensation and unemployment insurance funds; (4) right to discharge; and (5) permanency of the relationship." *Prof'l & Executive Leasing, Inc. v. Commissioner*, 862 F.2d 751, 753 (9th Cir. 1988). *See also Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 323-24 (1992). The right to control is the factor *primer inter pares*. "In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished." *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730, 751 (1989). *See also Prof'l & Executive Leasing*, 862 F.2d at 753. The Treasury Regulations likewise explain:

> Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done, but how it shall be done. In this connection, it is not necessary that the

> employer actually direct or control the manner in which the services are performed; it is sufficient if it has the right to do so.

Treas. Reg. § 31.3306(i)-1(b).

As an initial matter, Mainstay did not possess a right to control the details and means by which services were to be performed, as the District Court held. (ER 27-29.) Instead, according to Mainstay's own documents, the clients maintained their right to control the detail of their workers' performance of services even after contracting with Mainstay. As Mainstay provided in a Standard Customer Agreement, the client "supervises the work of any Mainstay Business Solutions employee assigned to the [client's] workplace." (Doc. 31-1 at 5.) This is consistent with Mainstay's Employee Handbook, which explains, "[y]our day-to-day job duties, hours and activities will be directed by management at your worksite company." (Doc. 32-1 at 6.) Although Blue Lake argues in its brief (Br. 59) that Mainstay possesses a contractual right to control the manner and means of the workers' performance because the supervisory personnel at a worksite were themselves subject to its rights to hire and fire them, this argument has little traction. As the District Court noted (ER 28), Blue Lake "never suggest[s] that Mainstay had any degree of control over the

details and means of the supervisors' service." Nor could it, considering that Mainstay's Management Guide explicitly states that "your day-to-day job duties, hours and activities will continue to be directed and supervised by your 'previous employer.'" (Doc. 32-2 at 72.) In other words, again taken from the Management Guide, "[a]lthough Mainstay will be integrated into areas involving employee services, your employees still work for your company and you still direct their day-to-day activities in the workplace." (Doc. 32-2 at 4.)

The District Court also correctly refused to cobble together a right to control from Mainstay's general oversight rights. As stated previously, the right to control means control "not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished." Treas. Reg. § 31.3306(i)-1(b). As the District Court observed (ER 29), Blue Lake "allege[s] various rights, such as input in the termination and hiring process, possession of personnel records, and control over benefits, but none of this amounts to supervision as to the means or detail of the work." Moreover, the general oversight rights that Mainstay contractually possessed, "which exist for all types of employment and do not relate to the details of any particular job," do not indicate that Mainstay had

any actual right to control the workers' jobs. (*Id.*) In short, although Mainstay had some illusory trappings of control, the clients alone possessed the right to control and direct the details of their workers' performance of services.

Blue Lake attempts to salvage its claim by pointing to various other factors that it contends establish Mainstay's status as a common-law employer. (Br. 58.) Aside from Mainstay's purported right to control, Blue Lake relies on its hiring and termination rights, its control of payments to workers, its provision of employee benefits to workers, its tax treatment of the workers, and that the employment of workers was part of regular business. (*Id.*) These are insufficient, however, to establish a common-law employment relationship. While the Standard Customer Agreement provided that Mainstay would "recruit, screen and hire employees for assignment at [client's] place of business in accordance with the job requirements and job descriptions provided by [client]" (ER 111), in practical terms, Mainstay simply hired that workforce that had just been fired by the client, according to Mainstay's chief executive officer. (ER 105.) Moreover, a Mainstay client could end its employment relationship with any worker, simply notifying Mainstay if it "should decide it no longer wishes to accept the

services of any particular" worker, according to a Standard Customer Agreement. (ER 113.)

The other factors do not weigh in favor of a common-law employment relationship, but simply demonstrate the services offered by Mainstay to allow a client to "focus on its business," as Mainstay states in its Employee Handbook. (ER 75.) Mainstay functions as an imported human resources department for its clients, most of which "did not have sophisticated in-house Human Resources expertise," according to the declaration of Mainstay's director of client services. (ER 68.) Mainstay fills the gap in its clients' businesses, "clarifying policies and procedures for employees, providing wages and benefit programs, assisting in worksite company safety compliance, . . . [and] assisting both employees and worksites with problem resolution," according to Mainstay's Employee Handbook. (ER 75.) As the District Court noted (ER 31), "Mainstay is in the business of assuming duties related to pay, benefits, and human resource supervision, as described above, and of leasing its employees services to its clients -- its relationship to [its clients' workers] is not dependent upon the nature of the services they provide." The District Court correctly concluded that, even "assuming that Mainstay accepts a more robust set of duties

and rights than most employee-leasing agencies, . . . it has failed to establish that its role is that of a common law employer." (*Id.*)

D. Blue Lake's remaining arguments are meritless

Blue Lake introduces two other arguments in an attempt to defeat the result compelled by the FUTA language, but, we submit, to little avail.

1. Blue Lake first argues that the California Unemployment Insurance Appeals Board addressed the "exact issue presented by the Tribe's claims in this action . . .[holding] that the individuals to whom the Tribe paid wages in 2003 and 2004 performed services in the Tribe's employ, and that those services were excluded from 'employment . . . solely by reason of paragraph (7) of section 3306(c)." (Br. 47.) Blue Lake then asserts that the District Court improperly disregarded the Appeals Board's decision when determining whether Mainstay's status as a statutory employer entitled it to claim the tribal exemption from FUTA tax on the wages it paid its clients' workers. (Br. 46-50.) The Appeals Board's decision, however, related to provisions of California law, not FUTA, and offers no real support for Blue Lake.

As discussed previously, the issue before the Appeals Board was whether Mainstay could elect to pay unemployment benefits under the reimbursement financing method provided by California law. (ER 145.) To make such a determination, the Appeals Board stated that "it must be decided whether the temporary workers of Mainstay Business Solutions provide services for Mainstay." (*Id.*) The CUIC deviates from the common law view, and from FUTA, by expressly expanding its definition of employer to include a "temporary services employer" and "a leasing employer," pursuant to CUIC § 606.5(b), (c). (*Id.*) The Board thus concluded that, for purposes of California's unemployment law, "[a]lthough the actual services of Mainstay Business Solutions employees are services of individuals that work for third-party customers, they are employees of Mainstay under section 606.5 of the Code." (*Id.*)

As the District Court noted (ER 31), the Board's "decision did not purport to interpret § 3306(c)(7)." Rather, its decision that Mainstay was eligible for the reimbursement method depended exclusively on the CUIC provision that extended the definition of employer to include a "leasing employer." (ER 145-46.) This California provision has no

analog in FUTA, and thus can have no effect on the instant FUTA analysis.[14]

2. Blue Lake also argues that the District Court exaggerated the potential for abuse from its reading of the statute, contending that "the District Court has substituted its own policy judgments for those of Congress." (Br. 55.) The District Court's concerns are well-founded. Under Blue Lake's view, any entity eligible for an exemption from employment (and therefore FUTA liability) under I.R.C. § 3306(c) could provide services as a statutory employer under I.R.C. § 3401 and offer its exemption as a shield to protect employers, who were not eligible for exemptions themselves, from their proper FUTA liability. As the District Court noted (ER 24), this "would create a theoretically limitless potential for abuse."

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[14] Blue Lake expresses a concern (Br. 49) that if Mainstay "fails to reimburse the State for its unemployment claims," it shall be "not excepted from employment under I.R.C. § 3306(c)(7) until any such failure is corrected," pursuant to I.R.C. § 3309(d). Blue Lake then argues that this result would put it "in a worse position than other governments." (*Id.*) Blue Lake is incorrect. As an initial matter, Mainstay would be 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. Moreover, Mainstay is not required to elect the reimbursement method, if it might lead to an unpalatable result. Although the Appeals Board ruling allows Mainstay to use such a method, it does not dictate it, and thus it is Mainstay's choice whether to employ reimbursement financing, with Mainstay alone bearing any negative consequences that flow from its decision.

CONCLUSION

For the reasons stated above, the District Court's judgment should be affirmed.

Respectfully submitted,

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AUGUST 2010

STATEMENT OF RELATED CASES

The United States, pursuant to 9th Cir. Rule 28-2.6, states that there are no related cases in this Court.

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