TURNABOUT IS FAIR PLAY: PAYMENTS BY A HOSPITAL TO FORMER RESIDENTS IN FICA DISPUTE ARE SUBJECT TO INDEMNIFICATION

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The Federal Insurance Contributions Act ("FICA"), I.R.C. §§ 3101-3128, requires employers to deduct a tax from the wages paid to employees, but it has an exception for wages paid to students. *See* I.R.C. § 3121(b)(10). For a number of years, the question whether medical residents qualified for this exception was disputed. The official position of the IRS was that medical residents did not qualify for the student exception, but it allowed both residents and hospitals to file protective refund claims. Then on March 2, 2010, the IRS issued an announcement that it would honor refund claims previously filed for periods prior to April 1, 2005, when a relevant regulation took effect. I.R.S. News Release IR-2010-25 (Mar. 2, 2010).

Although the issue whether residents are subject to FICA is now resolved, there was recently another plot twist: On January 31, 2018, a divided panel of the Court of Appeals for the Federal Circuit ruled that a hospital that had settled a suit by former residents over FICA withholding could pursue an indemnification claim against the United States. *N.Y. & Presbyterian Hosp. v. United States*, No. 2017-1180, 2018 U.S. App. LEXIS 2410 (Fed. Cir. Jan. 31, 2018). The case turns on a single sentence in the Code: "Every employer required so to deduct the [FICA] tax shall be liable for the payment of such tax, *and shall be indemnified against the claims and demands of any person for the amount of any such payment made by such employer*." I.R.C. § 3102(b) (emphasis supplied).

The taxpayer, New York & Presbyterian Hospital, was sued by former residents in 2013 because it had not filed protective refund claims in the period between January 1996 and June 2001. *N.Y. & Presbyterian Hosp.*, 2018 U.S. App. LEXIS 2410 at *4. Ultimately, the case was settled in November 2015 for approximately $6.6 million. *Id.* at *5-*6. In April of 2016, the hospital filed a complaint in the Court of Federal Claims, arguing that it was entitled to be indemnified and seeking to recover the amount that it had paid to resolve the plaintiffs' claims. The government responded with a motion to dismiss, which was granted. *Id.* at *6.

On appeal, the majority began by noting that the Tucker Act, which provides the Court of Federal Claims with jurisdiction over claims against the United States, does not create substantive rights. As a

consequence, the majority noted that a plaintiff must identify a "money-mandating" source of substantive law to create jurisdiction. *Id.* at *7 (quoting *Fisher v. United States*, 402 F.3d 1167, 1172 (Fed. Cir. 2005)). Next the court observed that the right to recover could be express or implied, noting that in *United States v. Mitchell,* 463 U.S. 206 (1983), the Supreme Court had adopted a standard that a statute was money-mandating if it could "fairly be interpreted" to require the federal government to provide compensation for harm suffered by the claimant. 2018 U.S. App. LEXIS 2410 at *7 (quoting *Mitchell*, 463 U.S. at 216-17).

The majority then turned to the central issue: Is section 3102(b) of the Code a money-mandating statute? The hospital argued that it was because the phrase "shall be indemnified" could be fairly interpreted to mandate compensation. *Id.* at *9. In contrast, the government's position was that the statute was intended to provide immunity. *Id.* The majority then looked at the plain language of section 3102(b), focusing on the key word, "indemnified." The court considered three dictionaries that were roughly contemporaneous with the enactment of the provision, noting that each of them mentioned compensation in defining the word "indemnify." *Id.* at *10-*13.

The majority found the government's approach less persuasive. Both the government and the trial court had focused on the first definition listed in each dictionary, treating them as the "primary" definition. *Id.* at *13. In the court's view, this was inconsistent with the fair interpretation standard, which only asks whether a statute is reasonably amenable to a construction that provides for a right to compensation. *Id*. at *13-*14. The majority also noted that the dictionaries indicated that the first definition listed was not the primary definition; it was simply the oldest. As a consequence, the order in which the definitions were listed was not dispositive. *Id.* at *14-*15.

The government also argued that the hospital's construction of section 3102(b) would produce absurd results, positing that an employer could first withhold and pay over the tax, then pay its employees back and seek reimbursement from the government. *Id.* at *15. The panel majority gave this argument very short shrift, focusing on the presumption that the legislature means what it says. *Id.* at *15-*16. Consequently, the majority concluded that the term indemnify was commonly understood to mean compensate or reimburse at the time that section 3102(b) was enacted, making it reasonable to interpret the statute as a money-mandating statute. *Id.* at *16.

Next, the majority turned to related provisions of the Code. It initially noted that two provisions of the Code governing withholding from railroad workers and income tax withholding "provide that the 'employer . . . *shall not be liable* to any person for taxes deducted.'" *Id.* at *16 (quoting I.R.C. §§ 3202(b), 3403) (emphasis by the court). Initially, both provisions contained the same "indemnity" language as section 3102(b), but Congress elected to amend sections 3202(b) and 3403 without changing section 3102(b). *Id.* at *16, n.14. In the majority's view, the different language in section 3102(b) should be given a different meaning from sections 3202(b) and 3403, reinforcing its conclusion that the term "indemnify" could be plausibly interpreted as providing for compensation.

The panel majority then turned to the refund statute, section 7422 of the Code. In the court's view, section 7422(f) of the Code, which provides that a refund action can only proceed against the United States, demonstrated that "Congress knew how to craft an immunity provision when it so desired." *Id.* at *18 (citation omitted). The panel majority concluded its analysis by focusing on the legislative history of section 3102(b)'s precursor, section 802(a) of the Social Security Act. The House Report included a passage indicating that the statute provided an employer with indemnification for employee claims "up to the correct amount withheld and paid to the United States." *Id.* at *19 (quoting H.R. Rep. No. 74-615 at 30 (1935)). Accordingly, the panel majority concluded that section 3102(b) was a money-mandating statute.

There was a thoughtful dissent from Judge O'Malley. In her view, Federal Circuit precedent required a focus not on what was a permissible construction of section 3102(b), but on the correct construction: "There may be multiple reasonable ways to read a statute, but whether a statute is money-mandating is ultimately a yes-or-no question, presumably governed by the *more reasonable* and fair reading of the statute." *Id.* at *23 (O'Malley, J. dissenting) (emphasis in the original). After considering the prevailing definitions of the term "indemnity," Judge O'Malley concluded that the term was ambiguous. *Id.* at *29-*30.

Since the plain language was not dispositive, Judge O'Malley then turned to the refund statute as providing appropriate context. Given the fact that section 7422 requires tax refund claims to proceed against the government, Judge O'Malley concluded that "it would make no sense for § 3102(b) to give the *employer* a right of reimbursement." *Id.* at *31 (O'Malley, J. dissenting) (emphasis in the original). While her argument is conceptually sound, it ignores the fact that the hospital wound up paying what in effect were refund claims because the district court handling the residents' case apparently misapplied section 7422.

Judge O'Malley also disagreed with the majority's focus on the different language used in section 3102(b), which uses the term "indemnified," and in sections 3202(b) and 3403, which clearly provide immunity. Her quarrel was not with the principle that different language should be construed differently; instead, she observed that the principle "applies with substantially less force to legislative activity like this, where the statutes in question were enacted piecemeal over the course of decades." *Id.* at *33 (O'Malley, J. dissenting).

The case is interesting for a variety of reasons. From a taxpayer's perspective, the prospect that the hospital has a remedy on this fact pattern is good news. In terms of whether section 3102(b) is a money-mandating statute, the question is a close call, as both the majority and dissenting positions make valid points. It will be interesting to see if the case is reheard *en banc* review.

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