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IN THE SUPREME COURT OF THE UNITED STATES

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UNITED STATES, :  
Petitioner :  
v. : No. 01-463  
FIOR D'ITALIA, INC. :  
- - - - -X

Washington, D.C.  
Monday, April 22, 2002

The above-entitled matter came on for oral  
argument before the Supreme Court of the United States at  
10:03 a.m.

APPEARANCES:

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Department of Justice, Washington, D.C.; on behalf of  
the Petitioner.  
TRACY J. POWER, ESQ., Washington, D.C.; on behalf of the  
Respondent.

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P R O C E E D I N G S

(10:03 a.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument first this morning in Number 01-463, United States v. Fior D'Italia. Ms. O'Connor..

ORAL ARGUMENT OF EILEEN J. O'CONNOR

ON BEHALF OF THE PETITIONER

MS. O'CONNOR: Mr. Chief Justice, and may it please the Court:

This case is about the authority of the Commissioner of Internal Revenue to assess FICA taxes that Congress has imposed on employers. It also involves the well-established principle of tax litigation. It involves two key sections of the Internal Revenue Code and how they relate to each other, and it involves the evidentiary value of assessment in tax litigation.

The first of the key sections is section 6201. It appears at page 62a of the appendix to our petition. It authorizes and requires the Secretary of the Treasury to make inquiries, determinations, and assessments of all taxes imposed by the Internal Revenue Code. The second key section is 3111. It appears at page 55a of the appendix to our petition. This section imposes a tax on employers. The tax is measured by the wages they pay or are deemed to have paid their employees.

1                   QUESTION: Which section is this, Ms. O'Connor?

2   I'm --

3                   MS. O'CONNOR: Section 3111 at page 55a of our  
4   appendix to the petition.

5                   QUESTION: Thank you.

6                   MS. O'CONNOR: This is the tax that imposes --  
7   this is the provision that imposes a tax on the wages  
8   employers pay or are deemed to have paid their employees.

9                   The question this case presents is how the  
10   commissioner carries out his obligation under 6201 to  
11   assess the tax that is imposed by section 3111. The tax  
12   is --

13                  QUESTION: Ms. O'Connor, let me tell you what  
14   troubles me a little about the Government's position in  
15   the case, and I hope you will address this. How can an  
16   employer ever challenge effectively an assessment made  
17   under the position that you approach, because the normal  
18   burden of proof in a tax refund case normally requires the  
19   employer to show exactly how much money was owed, and I  
20   don't see how that would work in this context.

21                  MS. O'CONNOR: Exactly, Your Honor. The  
22   Congress has recognized the difficulty that employers have  
23   in this regard, and that is the reason there are several  
24   of the other sections that we will discussing this  
25   morning. Section 6205, for example, is mentioned in your

1 materials. That is a provision that permits employers on  
2 their own, if they discover an error, to correct it later  
3 and have no interest assessed. That's a very unusual  
4 provision, and it relates specifically to the complexity  
5 of employment taxes and their administration.

6 QUESTION: Well, would that error ever be  
7 anything more than a disparity between what the employee  
8 reported and what the employer reported?

9 MS. O'CONNOR: Would what, Your Honor?

10 QUESTION: How -- I mean, the error that that  
11 section -- I'm wondering what the error is that that  
12 section contemplates, and I can see it's application,  
13 let's say, if the employer simply added up the employee's  
14 reports wrong and got the wrong figure. Under what other  
15 circumstances would it apply short of the moment at which  
16 the Government makes the assessment which is in question  
17 here?

18 MS. O'CONNOR: It could also apply just -- and  
19 6205 is not specific to restaurants or food or beverage  
20 establishments or tips at all, because another common  
21 error that employers can sometimes make is  
22 mischaracterizing a worker as an independent contractor,  
23 for example, and upon determining later that the person is  
24 actually an employee and they should be withholding  
25 FICA --

1           QUESTION: Well, let me ask the question in  
2 another way. How would it -- how could it apply in this  
3 situation? In other words, as I understand it -- I mean,  
4 this is -- I didn't mean to side-track you from Justice  
5 O'Connor's question, but I'll raise the thing that bothers  
6 me. As I understand it, what the employer is obligated to  
7 report is the sum total of all the reports that the  
8 employees give to the employer of tip income.

9           MS. O'CONNOR: That's right, Your Honor.

10          QUESTION: And I'll assume for the sake of the  
11 question that a given employer has done that.

12          MS. O'CONNOR: Mm-hmm.

13          QUESTION: I also assume that if you are  
14 correct, that employer has this possibility hanging over  
15 it that the IRS is going to make this kind of an  
16 assessment.

17          MS. O'CONNOR: That --

18          QUESTION: Is there any -- my question is, is  
19 there any way that the employer can anticipate this kind  
20 of an assessment in order at least to avoid the interest  
21 running under this section?

22          MS. O'CONNOR: Absolutely. There are many  
23 different ways, Your Honor, and this case provides a very  
24 good example. Employees are required to report on a  
25 monthly basis to employers. You can see from the forms

1 8027, which are at pages 38 and 39 of the joint appendix,  
2 those are the forms that this restaurant filed for 1991  
3 and 1992.

4 QUESTION: And they were all correct, I take it.

5 MS. O'CONNOR: Right, those forms were  
6 absolutely correct.

7 You will also note at the top of the page it  
8 says that it is an information report, because this is  
9 information that Congress has required food and beverage  
10 establishments to provide to the Internal Revenue Service  
11 exactly for a purpose such as this.

12 Now, the annual -- the information report at  
13 pages 38 and 39 is an annual report that the food and  
14 beverage establishment provides to the Internal Revenue  
15 Service, but employees provide reports to employers at  
16 least monthly. You will see on the forms 8027 that 90  
17 percent of the sales of this restaurant were paid for by  
18 credit card, so every single month this restaurant could  
19 have compared the tips that employees were reporting with  
20 the tips that they saw were being charged on credit cards,  
21 and as any business owner would do when faced with a  
22 liability that could occur down the road, you're going to  
23 set up a reserve for it.

24 You know you have got your annual insurance  
25 premium due next January. You start setting aside for it.

1           QUESTION: He may set up -- the employer may set  
2 up a reserve, but as I understand it the employer is not  
3 obligated, in effect, to withhold upon himself, is not  
4 obligated to pay the tax on it until the assessment comes,  
5 because under the IRS' instructions the employer pays the  
6 tax on the amounts reported to the employer even if he  
7 knows they're wrong.

8           MS. O'CONNOR: That's exactly right, and that's  
9 another indication of the fact that Congress realized that  
10 this was going to be a difficult provision for employers  
11 to enact.

12           QUESTION: Well, what would he do --

13           MS. O'CONNOR: 31 --

14           QUESTION: What would he do to anticipate it?  
15 Would he say, I'm paying you another \$10,000, I don't  
16 happen to owe you that in tax now, I paid what the law  
17 requires me to pay, and you haven't assessed anything  
18 else, but here's another \$10,000? I mean, is that what  
19 you're anticipating?

20           MS. O'CONNOR: Absolutely not, Your Honor. In  
21 fact, it is the rare taxpayer who seeks to pay his tax  
22 before it's called for.

23           (Laughter.)

24           QUESTION: All right, then how does the taxpayer  
25 take advantage of the provision that allows him to make a



1 correction and avoid the interest in this case?

2 MS. O'CONNOR: Well, one of the things that is  
3 somewhat troublesome about some of the briefs in front of  
4 you from the other side is that the other side is looking  
5 at this as though it was a penalty, and it's not a  
6 penalty, it's merely a tax. In fact, there specifically  
7 are no penalties. Let me point out --

8 QUESTION: I will assume -- no, I will assume  
9 it's no penalty. I just want to know how it works in this  
10 situation. He doesn't owe any tax --

11 MS. O'CONNOR: Right.

12 QUESTION: -- based on what he has to report to  
13 you.

14 MS. O'CONNOR: Right.

15 QUESTION: You haven't assessed anything yet.  
16 How can he possibly take advantage of the provision that  
17 allows him to make a correction, to pay in accordance with  
18 that correction, and to avoid any interest that he would  
19 otherwise be liable for? How can he take advantage of it?

20 MS. O'CONNOR: Well, let me point out a couple  
21 of things from your question, Justice Souter. First, let  
22 me direct you to 3121(q). Provisions of the Internal  
23 Revenue Code provide a couple of things. They provide  
24 what is tax, how is the tax measured, when is it  
25 measured --

1 QUESTION: Where is 2131(q)?

2 MS. O'CONNOR: 3121(q) is in our joint appendix  
3 here -- oh, no, no, it's in the petition. Thank you.  
4 3121(q) is at 58(a). Thank you very much.

5 QUESTION: General O'Connor, it might help if  
6 you answered specifically whether interest does run on the  
7 period between the employer paying what the employee's  
8 reports call for and the assessment at a higher amount.

9 MS. O'CONNOR: Thank you, Justice Ginsburg. No,  
10 there is no interest that runs, and that's why I wanted  
11 you to look at 3121(q) in particular.

12 QUESTION: Then how does this section have an  
13 application here? You say, well, this mitigates it,  
14 and --

15 MS. O'CONNOR: No, I'm sorry --

16 QUESTION: -- it seems to me that about all the  
17 employer can do is pay immediately at the moment of your  
18 assessment and therefore no interest will run.

19 MS. O'CONNOR: No, I did not mean to suggest  
20 that 6205 applied to this assessment, and in fact it  
21 doesn't. 6205 applies when the employer himself discovers  
22 an error and corrects it at the next available  
23 opportunity.

24 QUESTION: So it wouldn't apply in these  
25 circumstances.

1 MS. O'CONNOR: It doesn't need to, because under  
2 3121(q) -- it's a very interesting provision. 3121  
3 provides definitions, that's all. It resides in the  
4 subchapter of the Internal Revenue Code that provides for  
5 these employment taxes, and (q) is the definitional  
6 provision that says that tips are wages. It also tells  
7 you when the tips are wages.

8 For the purposes of the employer FICA 3121(q)  
9 tells you that the wages are deemed to have been paid when  
10 the employee reports them or if the employer -- employee  
11 doesn't report them, they are wages deemed to be paid when  
12 the IRS issues notice of demand, so until the IRS notifies  
13 the restaurant that there is an additional FICA tax due,  
14 there is no interest or penalty.

15 QUESTION: Right, but at that point there is,  
16 and if you would come back to Justice O'Connor's question,  
17 which was, how could the employer ever know that there was  
18 a mistake in the assessment, and you said, well, as soon  
19 as he knows it, he can come forward with the additional  
20 amount and there won't be any penalty, but how does he  
21 know it? That's the problem.

22 MS. O'CONNOR: He knows it because the employees  
23 are reporting on a monthly basis, and in this case there  
24 was clearly -- we have \$120,000 of unreported credit card  
25 tips in each of the 2 years involved here, \$120,000 in

1 unreported credit card tips. Those reports were coming in  
2 every month. The restaurant has clear notice --

3 QUESTION: But your assessment is for more than  
4 that. Your assessment assumed a certain unreported amount  
5 of cash tips as well. Now, how is the reporter -- how is  
6 the employer going to know whether that's erroneous or  
7 not?

8 MS. O'CONNOR: The same method that he would use  
9 to make any other determination. For example, he knows by  
10 the basis of the report that all credit card tips are not  
11 being reported.

12 QUESTION: But the burden is on him. The burden  
13 is on him to show what the proper amount was. I mean, IRS  
14 comes up with a guess based on, well, we assume that the  
15 same amount weren't reported for cash tips as weren't  
16 reported for credit card tips, pay up.

17 Now, how is he going to prove that there was a  
18 different amount for --

19 MS. O'CONNOR: You're exactly right, Justice  
20 Scalia, the burden is on the taxpayer, and in this case  
21 the taxpayer conceded the entire amount of the judgment.  
22 Page 35 of the joint appendix --

23 QUESTION: But the burden is on the taxpayer to  
24 give information as to which the taxpayer is not in the  
25 best position to know, and --

1 MS. O'CONNOR: That's true, Justice Kennedy.

2 QUESTION: -- Justice O'Connor's original  
3 question was, how is the employer supposed to know, and  
4 you say, well, if he doesn't know he can amend later.

5 The whole question is, and the gravamen of the  
6 argument put forth by the taxpayer here is that the  
7 assessment should be on the person, or on the entity that  
8 has the information, and here your information is as good  
9 as the employer's, and you have the ability to do what the  
10 employer can't, i.e., subpoena the individual records of  
11 the employees.

12 MS. O'CONNOR: Actually, not all of that is  
13 true, Justice Kennedy. The employer, if there were a  
14 dispute between the employer and the employee the employer  
15 certainly could subpoena records of the employee in a  
16 matter such as that, and respondent, as you say, does --

17 QUESTION: How does he do that, sue the  
18 employee?

19 MS. O'CONNOR: Oh, if -- yes, if there were a  
20 dispute between the two over any matter the employer  
21 certainly could.

22 QUESTION: You're talking about a tax court or a  
23 district court, or --

24 MS. O'CONNOR: No, just as a general  
25 proposition. Just as a general proposition. In this

1 case --

2 QUESTION: Well, as a general proposition I  
3 don't think the employer can subpoena the employee. I  
4 mean, you have to have a legal proceeding, don't you?

5 MS. O'CONNOR: Oh, exactly. That's what I mean,  
6 Your Honor. If there were some other legal proceeding --

7 QUESTION: Well, but I mean, that's not going to  
8 work. You're suggesting that he ought to fire the  
9 employee and then be subjected to a wrongful discharge  
10 suit and then subpoena the information so that he can give  
11 it to you. Why don't you just ask for it?

12 MS. O'CONNOR: Well, actually, there is no  
13 evidence in the record on whether the individual employees  
14 were audited or not. I saw that in the Ninth Circuit  
15 opinion, TRAC is asserted on that point.

16 QUESTION: But the point is, you have the  
17 capacity to do it and the employee doesn't.

18 MS. O'CONNOR: That's true, Justice Kennedy.  
19 The amount of assessment, though, I think it's very  
20 important to focus on the fact that in this case, as you  
21 can see at page 35 of the joint appendix, the taxpayer  
22 here conceded the reasonableness of the assessment,  
23 conceded it.

24 QUESTION: Then that's just luck, because I  
25 thought Justice O'Connor's original question was, look, we

1 can all do this, it's so simple. You multiply 14.3  
2 percent times the gross receipts of every restaurant in  
3 the country, all right. Now, I thought her question was,  
4 what is the restaurant owner supposed to do to show that  
5 that's inaccurate, what can he do, and so far my own  
6 conclusion listening to you is, he can write the check.

7 MS. O'CONNOR: I'm sorry, I didn't mean to --

8 QUESTION: Now, is there anything else -- is  
9 there anything else that this restaurant owner has it in  
10 his power to do, other than write the check, and not some  
11 theoretical thing. What I'm interested in is the  
12 practicality of it.

13 MS. O'CONNOR: Absolutely, Your Honor --

14 QUESTION: What is that?

15 MS. O'CONNOR: -- and I don't mean to be  
16 avoiding the question. Let me point to another line on  
17 the form, 8027. You'll notice there is a line that refers  
18 to 8 percent, and then there's a blank and it says, or  
19 lower percentage. The reason for that is that if a  
20 restaurant employees are reporting tips that are less than  
21 8 percent of gross sales, that could raise a red flag that  
22 maybe the restaurant worker --

23 QUESTION: It's not about 8 percent. Everybody  
24 knows all these minimums. This is about people who are  
25 earning more than the \$20 in tips per year.

1 MS. O'CONNOR: Right, per month.

2 QUESTION: It is about people -- per month, or  
3 whatever.

4 MS. O'CONNOR: Right.

5 QUESTION: It is about people who satisfy all  
6 these other minimums. It is not about people -- they can  
7 even get a tax credit for this.

8 MS. O'CONNOR: Right.

9 QUESTION: I'll save that question.

10 MS. O'CONNOR: Right.

11 QUESTION: I'm interested in the answer to  
12 Justice O'Connor's question in what I'd call the mind run,  
13 mainstream, basic, typical situation, and that is, what is  
14 that answer? So far I'm concluding he can do nothing.

15 MS. O'CONNOR: No.

16 QUESTION: Tell me the answer.

17 MS. O'CONNOR: What the restaurant can do is  
18 show evidence that would tend to determine, or help  
19 determine the amount of the tip, how many -- what kind of  
20 a restaurant you have, how upscale it is, where it's  
21 located, the kind of meals you serve -- in fact, the IRS  
22 has a procedure where restaurants can show all that  
23 information, a sample menu to get below the 8 percent.

24 QUESTION: And then I'm not being clear.

25 MS. O'CONNOR: Right.



1           QUESTION: I think in typical cases like this  
2 one, the restaurant will have paid more -- they will have  
3 assumed that it is more than 8 percent. They wrote a  
4 check for -- they assumed it was \$200,000. That's going  
5 to be more than 8 percent of gross receipts.

6           MS. O'CONNOR: Right.

7           QUESTION: All right. Now, we're only talking  
8 about an area that's well above that, and in respect to  
9 the area well above that. Here it happened to be between  
10 \$200,000 and about \$350,000. In respect to that extra  
11 \$150,000, you come in and say, we're sure that it was  
12 earned in tips, and now here's what you did. You  
13 multiplied gross receipts by 14.3 percent, and you  
14 subtracted the \$200,000, okay. I'm saying anyone can do  
15 that, and I thought Justice O'Connor's question was, you  
16 are a restaurant owner. You are faced with this. How do  
17 you show that it isn't so?

18           MS. O'CONNOR: The taxpayer here had the  
19 opportunity to do that. One of the things that you --

20           QUESTION: Well, but will you acknowledge at  
21 least that it's virtually impossible for the taxpayer to  
22 get that information? I mean, the taxpayer has the  
23 reports from the employees, and they're false.

24           MS. O'CONNOR: What --

25           QUESTION: How, as a practical matter, is the

1 taxpayer going to establish there's something different?  
2 I mean, we know in terms of generalities, we're told that  
3 there are less tips paid, or bills paid in cash than by  
4 credit card.

5 MS. O'CONNOR: That has been an insertion that  
6 is unproven in the record.

7 QUESTION: So you don't accept that as proof.

8 MS. O'CONNOR: It may or may not be true.

9 QUESTION: So what's the employer going to do,  
10 then?

11 MS. O'CONNOR: It may or may not be true.

12 QUESTION: Let me ask you one other thing.  
13 There's a so-called TRAC system, right, that Congress  
14 passed to address this very problem. What percentage of  
15 restaurants have used TRAC? Does the record tell us that?

16 MS. O'CONNOR: No, the record doesn't tell us.  
17 I understand from news reports that increasing numbers of  
18 employers are entering into the tip rate alternative  
19 commitment, and that is an alternative to justifying or  
20 trying to establish -- in this case, though, let me point  
21 out that at any point during the IRS' examination the  
22 taxpayer could have shown, could have produced information  
23 that would have reduced the number that you see on Exhibit  
24 A. They never did that --

25 QUESTION: But where would he get --

1 MS. O'CONNOR: -- and they didn't do it in the  
2 district court, either.

3 QUESTION: Where would the taxpayer get the  
4 information? The only thing the taxpayer has got are the  
5 employee's returns to the taxpayer and your assessment.  
6 Where is the taxpayer going to get the information that  
7 would allow it to do what you say in theory it could do?

8 MS. O'CONNOR: Well, magically, since its  
9 concession in the district court, at the appellate level  
10 and again in its briefs before this Court, the respondent  
11 has come up with all sorts of ideas that might challenge  
12 the amount of the assessment. Even if the --

13 QUESTION: But there is a stipulation in this  
14 case -- whatever may be in the next case, there is a  
15 stipulation in this case that they are not contesting the  
16 method. I have a question that I think Justice Breyer has  
17 said he was reserving, and that is, I don't understand  
18 what's in this for the revenue, because of the -- the  
19 provision you haven't mentioned, 45B gives the restaurant  
20 a credit against income tax, dollar for dollar, for the  
21 FICA tax, and let's assume we have employers, most of them  
22 are paying at least the minimum wage, what gain is there  
23 to the revenue whichever way this comes out?

24 MS. O'CONNOR: We don't know whether the  
25 taxpayer here was paying the minimum wage, because none of

1 that was in the record, because the assessment amount was  
2 conceded. The 45B credit, as you point out, is available  
3 only for tips that are not used by the employer to satisfy  
4 his minimum wage obligations, yet it's not a complete wash  
5 to the Treasury, however, because you still have the FICA  
6 tax being paid in and an income tax credit being given, so  
7 it's the trust fund accounting that would have a problem  
8 if you look at it as a complete offset. From the  
9 Government side it's not a complete offset at all.

10 Let me emphasize that the concession in this  
11 case --

12 QUESTION: Excuse me, I didn't understand that.

13 MS. O'CONNOR: Yes.

14 QUESTION: Go over that again. What trust fund?

15 MS. O'CONNOR: The social security trust fund,  
16 so to speak.

17 QUESTION: So to speak, yes.

18 (Laughter.)

19 MS. O'CONNOR: Well, it is a matter of  
20 Government accounting. As a matter of Government  
21 accounting.

22 QUESTION: It's a fantasy, isn't it? I mean, it  
23 all goes into one pot, doesn't it?

24 MS. O'CONNOR: As a matter of Government  
25 accounting, there are funds that are --

1           QUESTION: Purely as an accounting matter it  
2 makes a difference, is that it?

3           MS. O'CONNOR: As a Government funding matter.  
4 As a Government funding matter.

5           QUESTION: From the point of view of the  
6 taxpayer it makes no difference, I take it?

7           MS. O'CONNOR: From the point of view of the  
8 taxpayer, it will make a difference if they use tips to  
9 satisfy their minimum wage requirement, and on this record  
10 we don't know.

11          QUESTION: And if they don't, it won't make  
12 that -- a difference.

13          MS. O'CONNOR: It will -- well, no, that's not  
14 entirely true, but it's an optional credit. The employer  
15 can prove his eligibility for the credit and claim it, or  
16 rather than claiming the deduction, they can claim a tax  
17 deduction, which they might prefer to do.

18          QUESTION: What happens if the employer doesn't  
19 have enough, I guess, gross income to offset? Then he has  
20 to be stuck with the difference, right?

21          MS. O'CONNOR: Well, it is a nonrefundable  
22 credit, and that means you can either use the credit as an  
23 offset to your income tax, and what you're suggesting is  
24 they don't have any income tax. That kind of employer  
25 might prefer to take it as a deduction, which would create

1 a net operating loss which could carry forward and benefit  
2 a future year.

3 QUESTION: But the question -- and to overstate  
4 the point -- I'm not buying into this argument at the  
5 moment, but I do want to hear your response. From their  
6 briefs I have the impression that it doesn't make a lot of  
7 difference to the Government in this case. It would make  
8 a lot of difference to the Government in the case of  
9 restaurants that are losing money, in the case of  
10 taxicabs, hairdressers, newspaper boys, and anyone else  
11 who is in a business where people receive tips, and in  
12 respect to those kinds of cases it gives the Government a  
13 weapon.

14 In this case, it's being used to force them into  
15 a TRAC program that they don't want to enter. In some  
16 other case, to have a kind of threat that you could make  
17 to people because, of course, a lot of income is  
18 underreported through tips, and you'd always be able to go  
19 out and assess more.

20 Now, you're asking us to interpret some very  
21 broad language as saying Congress has given you authority  
22 to do a particular thing. They're saying, don't give them  
23 that authority. Congress would never have intended the  
24 IRS to do what I've just described.

25 Now, I want to be sure you have a clear

1 opportunity to answer that, because I want to hear what  
2 the answer is.

3 MS. O'CONNOR: Congress had the opportunity to  
4 say that no, the IRS does not have the authority to do  
5 what has been referred to here as aggregate assessment,  
6 and I might just point out here that rather than aggregate  
7 assessments, which is what the respondent calls what has  
8 happened here, respondent would prefer the individual  
9 audits and aggregating the estimates, because certainly  
10 they would be estimates if they were done on the basis of  
11 the individual waiter's reports also.

12 But in 1998, when Congress said that the IRS  
13 cannot use a threat of an assessment like this to force  
14 restaurants into a TRAC, it clearly had the opportunity to  
15 say, and besides, you don't have the authority to do these  
16 estimates anyway, these assessments anyway. The authority  
17 is very clear, and the only thing that the respondent has  
18 ever argued here is that the amount might be wrong, and  
19 they can't tell you exactly what it is, but there is no  
20 rule that an assessment has to be entirely accurate or  
21 precise. The assessment authority requires inquiries and  
22 determinations, and that's what's happened here.

23 QUESTION: The assessment is presumptively  
24 correct, isn't it, under the statute?

25 MS. O'CONNOR: Not under the statute, Justice

1     Rehnquist, Chief Justice Rehnquist, but rather under the  
2     laws that this Court has observed. In United States v.  
3     Janis, this Court commented on the presumed correctness of  
4     assessments and their evidentiary value in tax litigation.

5             QUESTION: Well, you take the position it is  
6     presumed to be correct, don't you?

7             MS. O'CONNOR: It is -- United States v. Janis  
8     stands for the proposition that an assessment is valid  
9     unless it is without any foundation. Clearly, here, when  
10    the assessment is based on the respondent's own report,  
11    and more than three-quarters of the assessment is on the  
12    amounts that are clearly known to be true, clearly this  
13    foundation, this assessment has a foundation. Thereafter,  
14    once you've established that the assessment is not  
15    invalid, that it has a foundation at all, then you start  
16    talking about the amount.

17            QUESTION: Well, I wonder --

18            QUESTION: No, please, go ahead.

19            QUESTION: Well, it has a foundation if three-  
20    quarters of it is true?

21            MS. O'CONNOR: Pardon me?

22            QUESTION: It has a foundation if three-quarters  
23    of it is true?

24            MS. O'CONNOR: Oh, no.

25            QUESTION: Is that what having a foundation



1 means?

2 MS. O'CONNOR: The test under Janis I think is  
3 much, much lower than that. It's -- an assessment is  
4 valid if it has any foundation at all --

5 QUESTION: So if --

6 MS. O'CONNOR: -- and clearly, this one has a  
7 foundation.

8 QUESTION: -- 1 penny on the dollar is accurate,  
9 that -- it has a foundation? Is that what it means? It  
10 couldn't mean that.

11 MS. O'CONNOR: Oh, I think that would be pushing  
12 it a little far, Your Honor, and that's not what United  
13 States v. Janis requires.

14 QUESTION: I would think it would mean that  
15 there's some reason to believe the full amount is  
16 accurate, not that three-quarters of it is accurate.

17 MS. O'CONNOR: That's not what this Court has  
18 held, particularly United States v. Janis, where in fact  
19 the assessment there was based on an estimate of wage-  
20 earning practice. By looking at 5 days' worth of wages  
21 the commission assessed on 77 days worth of wages.

22 QUESTION: Sure, but doesn't the Janis rule  
23 assume that the taxpayer is, in fact, in a position to  
24 prove the correct figure if the assessment is wrong?

25 MS. O'CONNOR: Not necessarily, Your Honor, and

1 it is incumbent upon any taxpayer upon whom a tax is  
2 imposed to maintain whatever books and records they can.

3 QUESTION: Exactly, and that comes back to the  
4 question I've asked before. What can this taxpayer do?

5 MS. O'CONNOR: Well, the taxpayer is in a  
6 business that requires a lot of things. There health,  
7 safety, and sanitation regulations. There are also tax-  
8 reporting regulations. You hire reliable people, you tell  
9 them what the rules are, you remind them what the rules  
10 are, and you facilitate their compliance, and that's what  
11 the restaurant here needed to have done, and may even have  
12 done. Since they didn't challenge the assessment or  
13 amount of the assessment, I think we can assume that --

14 QUESTION: Well, short of the restaurant's  
15 hiring someone to bird dog every single waiter and  
16 waitress to see what, in fact, the tip was, I don't see  
17 how the employer here could collect the information.

18 The gambler, sure, he can write it down in his  
19 little book, but I don't see where the employer here is in  
20 a position to get the figure to write down in a little  
21 book, short of having a third person follow every --

22 MS. O'CONNOR: The waiter can also write down  
23 his tips in a little book, and there are --

24 QUESTION: Sure, and the whole premise of the  
25 problem is that the waiter is in fact not telling the

1 whole truth.

2 MS. O'CONNOR: That is why restaurants --

3 QUESTION: I mean, that's just really  
4 impractical.

5 MS. O'CONNOR: -- every employer should hire  
6 reliable people who they can trust to follow the rules.

7 (Laughter.)

8 MS. O'CONNOR: I'd like to reserve the balance  
9 of my time for rebuttal.

10 QUESTION: Very well, Ms. O'Connor.

11 Ms. Power, we'll hear from you.

12 ORAL ARGUMENT OF TRACY J. POWER

13 ON BEHALF OF THE RESPONDENT

14 MS. POWER: May it please the Court, Your Honor:

15 Congress did not saddle the employer with a tax  
16 while depriving him of any way to defend against it.

17 Congress did not require the employer to do what for 30  
18 years it told him it was not required to do. This tax is  
19 not authorized. Because it's not authorized, that affects  
20 the burden of proof and the presumption of correctness.

21 I'd like to suggest an analogy. If Congress had  
22 passed a tax on my chickens and the IRS came along and  
23 said, we're imposing a tax on you, on your neighbor's  
24 cows, and I said, but I don't owe a tax on my neighbor's  
25 cows, and they in turn said, yes, well, what we did was,

1 we figured your neighbor had X number of acres and  
2 therefore the average number of cows per acre is Y, and  
3 you owe the tax on the cows, and I said, well, I'm not  
4 going to fight that because I don't have any way to know  
5 how many cows my neighbor had.

6 QUESTION: But can I just ask one question that  
7 really puzzles me in this case?

8 (Laughter.)

9 QUESTION: I can't follow the cows and all --

10 (Laughter.)

11 MS. POWER: I understand.

12 QUESTION: But you did have records, written  
13 records that showed that the actual amount of tips paid by  
14 credit card and so forth to the people in question here  
15 was substantially larger than you reported. Why shouldn't  
16 that put you on notice that you owed a little money to the  
17 Government?

18 MS. POWER: We do not know to what extent, if  
19 any, those credit card tip amounts, or the amount on the  
20 credit card tip slot on a credit card, was in fact  
21 received by an employee, a tip received by an employee  
22 that is wages subject to the act. We do not know what --

23 QUESTION: Well, but after those credit cards go  
24 to the restaurant, doesn't the restaurant turn the cash  
25 over to the employee?

1 MS. POWER: The restaurants handle it in a  
2 variety of different ways. It could be as simple as an  
3 employee at the end of the night starting to turn over all  
4 the money he's collected during the night, first to  
5 satisfy all the credit card bills, then to satisfy all of  
6 the dupes for the food that he had with the balance  
7 remaining in his pocket, which he then turns around and  
8 kicks out to a whole host of other employees. We do --

9 QUESTION: But don't you know what the practice  
10 is in your own restaurants?

11 MS. POWER: We would know what -- each  
12 individual restaurant would know what is done in basic  
13 practice in their restaurant, but how much, if any, of  
14 that credit card amount was retained by any individual, we  
15 do not know.

16 QUESTION: No, but what may -- I understand the  
17 waiter may have split the tips with the busboy and so  
18 forth and so on, but the total amount of tip on the credit  
19 card slip was paid to some employee, was it not?

20 MS. POWER: Well, we don't even know whether  
21 it's a tip. There are many reasons why it might not be a  
22 tip.

23 QUESTION: But this is a particular restaurant.  
24 I mean, it 's not as if we're talking about the world of  
25 restaurants. Surely this particular restaurant knows.

1 MS. POWER: Would know whether that credit card  
2 amount was, in fact, a tip? No. You could have well had  
3 a circumstance --

4 QUESTION: You mean if it's shown on the credit  
5 card --

6 QUESTION: As a tip --

7 QUESTION: -- as a tip -- I seem to recall  
8 seeing a space --

9 QUESTION: Yes.

10 QUESTION: -- on restaurant charges --

11 (Laughter.)

12 MS. POWER: That's correct.

13 QUESTION: -- that says, tip, X amount. You  
14 fill it in.

15 MS. POWER: And that's correct, and if I went in  
16 and I didn't have any cash in my pocket and I said to the  
17 waiter, you know, I'm going to leave some extra tip on  
18 here, I need to pay for the valet when I leave, I'm going  
19 to put \$5 extra on here, can you give me the cash -- yes,  
20 it's possible that there's tips on there.

21 QUESTION: The question isn't possible. The  
22 question is what's normal, and normal tip is tip, and I  
23 don't understand the chickens and the cows exactly --

24 (Laughter.)

25 QUESTION: In my copy of the code here it

1 says -- it doesn't say -- it says the employer, there is  
2 imposed on the employer an excise tax equal to 6.2 percent  
3 of wages, and it says, including tips, so I don't see  
4 how -- what your argument is that the tax isn't  
5 authorized. Of course it's authorized.

6 MS. POWER: But it's wages of an individual  
7 employee.

8 QUESTION: Yes, that's right, and the employer  
9 has to --

10 MS. POWER: It's wages -- and they have, what  
11 their assessment stands for is a tax on my gross tip  
12 payroll. There has been no -- that is not a tax --

13 QUESTION: No, no, but I -- I understand that  
14 basic point. I'm trying to get you to focus on what I  
15 think would be, despite the rights and wrongs of it, their  
16 very strong legal position, which is very simple.  
17 Number 1, that there is assessed here a tax on the  
18 employer equal to 6.2 percent of the total, including tip  
19 wages of the employee, all right, and they say, we have  
20 the power under the statute to assess the amount, and  
21 moreover, we think your client didn't pay, and therefore  
22 we took what we think was a very reasonable way of  
23 figuring that out.

24 We looked at the credit cards and we saw it  
25 said, tips, and we saw 14.2 percent is the typical amount,

1 and we assume that's it for credit and for cash, and if  
2 you don't like that, you prove to the contrary. We don't  
3 think you can prove it, not because it just isn't  
4 possible, that probably, in all likelihood, it isn't true,  
5 okay. Now, that's their point.

6 Now, you reply to that. I would like to hear  
7 your argument.

8 MS. POWER: My reply to that is, we started out  
9 by saying it's wages, including the tips of the employee,  
10 and they did not give us a bill for wages which are the  
11 tips of the employee. They gave us a bill for the total  
12 gross tips of all employees collectively, and this Court  
13 has already held that FICA taxes are divisible taxes under  
14 *Flora v. United States*, that it is a tax imposed upon the  
15 individual wage earnings. This Court has already  
16 interpreted 3111 to be a tax on individual wage earnings,  
17 and they did not give us a bill for that tax.

18 QUESTION: Well, but that's a different argument  
19 from the one that we've been wrestling with, which is  
20 whether or not you have within your authority and control  
21 an ability to calculate the basis for challenging the  
22 assessment.

23 MS. POWER: We do not.

24 QUESTION: And you began by saying, well, they  
25 differ and, frankly, I don't give much force to that



1 argument. The employer knows how the employer distributes  
2 credit card receipts. That's the employer's job, so I'm  
3 not particularly persuaded by that argument. If you want  
4 to go ahead and say, well, the cash portion of the tips  
5 don't relate to the -- in the same ratio that the credit  
6 card tips, I would understand that.

7 MS. POWER: The employer does not know how the  
8 tips, the credit card tips are distributed. It's not as  
9 if --

10 QUESTION: Doesn't the employer get the credit  
11 card receipt?

12 MS. POWER: At the end of the --

13 QUESTION: And doesn't the -- the employer can  
14 set up any system the employer wants.

15 MS. POWER: At the end of the evening the  
16 employer would cash out all the employees and would turn  
17 over credit card tips to employees who might have received  
18 credit card receipts, and those employees would then  
19 decide among themselves to whom in what amount they are  
20 going to share those tips that they have received, along  
21 with any cash tips that they may have --

22 QUESTION: But the employer at least has an  
23 aggregate at that point, some that appears from the credit  
24 cards to have been paid out in tips, no matter how it's  
25 shared.

1           QUESTION: In addition, he has the ability -- in  
2 addition, he has the ability to tell his employees that he  
3 wants to know the ratio in which they're shared. He can  
4 make that a condition of employment, so I'm not persuaded  
5 by that argument.

6           MS. POWER: I don't really think he can make  
7 that a condition of employment. I think that employers  
8 have to be very careful what happens in the context of  
9 wage and hour laws and tip-pooling regulations and so on  
10 and so forth.

11           QUESTION: Well, that seems to me all the more  
12 reason why the employer should have a strong interest in  
13 knowing how the division is being made.

14           MS. POWER: Well, I think that there are many  
15 employees who do not want the employer to have anything to  
16 do -- to know -- to do with the tip-sharing arrangements.  
17 It is -- tips are the property of the employee. Not only  
18 that, you have --

19           QUESTION: But the employer, Ms. Power, has an  
20 obligation to pay FICA tax, and has an obligation to pay  
21 it on the total earnings, and it isn't -- your cow analogy  
22 didn't just pass me by, because the tax on the employer is  
23 independent of the tax on the employee. Suppose these  
24 employees never paid a cent in FICA tax, and they went off  
25 to beach-comb some place, the FICA tax would be owed by

1 the employer just the same.

2 MS. POWER: That's correct.

3 QUESTION: So it's the employer's cow. The FICA  
4 tax belongs to the employer.

5 MS. POWER: The -- there is no question that the  
6 employer owes a FICA tax. He owes the FICA tax regardless  
7 of whether the employee is ever audited. He owes the FICA  
8 taxes regardless of whether the employee is ever assessed  
9 or the employee ever pays his taxes. It can be assessed  
10 against the employer at a completely different time from  
11 when it can be assessed against the employee.

12 The employer does not dispute that he owes a FICA  
13 tax. What the employer disputes is, I can't know what I  
14 owe that FICA tax on until you make some determination of  
15 what the individual earnings are, because until that time,  
16 I am denied all defenses employees have that they can  
17 raise, and there's a whole list of long --

18 QUESTION: But you know what -- in fact, you  
19 stipulated that you don't dispute the facts, the  
20 estimates, or determinations used by the IRS as a basis  
21 for its calculation of an amount of aggregated unreported  
22 tip income by all directly and indirectly tipped  
23 employees, which is your -- is on page 35 of the joint  
24 appendix. You agreed that you are in this case, for  
25 purposes of this case not disputing any of that.

1 MS. POWER: I do not -- we do not dispute the  
2 amount of the IRS' aggregate assessments because -- of all  
3 employees collectively, because we simply do not have the  
4 information to dispute that. Congress has prohibited us  
5 from having that information. We do not have that  
6 information. We have never had that information.  
7 Congress for 30 years has told us we do not have to  
8 concern ourselves with that information, and we do not  
9 have the wherewithal to dispute it.

10 So in this case, do I dispute that? No, because  
11 it is not worth disputing that or attempting to even  
12 whittle down that assessment in this case.

13 QUESTION: But your position is, we know that  
14 there is a disparity between what is reported and what is  
15 actually paid in tips. We know that both the employee and  
16 the employer independently owe a tax on that total amount,  
17 and we know about the shortfall, but there is nothing the  
18 Government can do. It's just stuck by what the servers  
19 put down on the monthly form that they file.

20 MS. POWER: There's plenty that the Government  
21 can do. The Government has the wherewithal to do  
22 everything, and that's exactly what Congress says should  
23 be done.

24 QUESTION: Well, the only thing that you've  
25 proposed, and tell me if I'm wrong about this, is that the

1 Government go one by one after the employees, and am I  
2 correct in saying that the same method would be used by  
3 the Government if it went against an individual server,  
4 that it -- you are resisting the Government using against  
5 the restaurant. That is, let's take a waiter in this  
6 establishment. The Government says, you've underreported  
7 your tip income, and the way we figured out that you've  
8 underreported it is the same formula. Isn't that what  
9 goes on when --

10 MS. POWER: No, it's entirely different,  
11 because -- and as the McQuatters case that's cited in the  
12 briefs by both parties illustrates, in that circumstance,  
13 the individual waiter has an opportunity to bring any  
14 defenses that he has to the Government's assessment  
15 forward, and we are denied every possible defense by that  
16 scenario.

17 QUESTION: Well, take -- make that specific,  
18 please. Here is a waiter, and the Government says, you  
19 have unreported income, and this is how we've estimated  
20 it. We've estimated it based on our formula, and then  
21 specifically what does that employee do when the  
22 Government says, we've made an estimate based on this 14  
23 percent, or whatever it is?

24 MS. POWER: The employee disputes the estimate.  
25 Whether he does it at an administrative level or whether

1 he goes to the tax court and disputes it, he goes in and  
2 he disputes it, and he raises the issues, and I think a  
3 number of them were identified in the waitresses' amicus  
4 brief. For instance, they say, well, I didn't work as  
5 long. I don't have the same experience as the other guy  
6 had. They was stiffing, a tremendous amount of stiffing.  
7 We had a European clientele, the tips weren't as great as  
8 you think.

9 QUESTION: What is stiffing?

10 MS. POWER: No tip whatsoever.

11 (Laughter.)

12 MS. POWER: I'm sorry.

13 QUESTION: I just don't understand how any of  
14 that can get you below the amount that shows up on the  
15 credit cards, because for example, say one employee got  
16 \$2,000 in tips, and he could have a defense that I passed  
17 out \$600 to the busboys, and maybe his liability is less,  
18 but it still seems to me the employer would have to at  
19 least pay the aggregate amount on the credit card.

20 MS. POWER: No, because --

21 QUESTION: I just don't understand how you get  
22 around that.

23 MS. POWER: -- there's a situation where you  
24 could have many employees. There's a very high turnover  
25 rate, especially with those who are in the categories that

1 receive the least amount of tips. Somebody who comes in,  
2 and he's a busboy and he's there for the afternoon, and he  
3 says, boy, forget this job, I'm leaving, and he takes the  
4 tips that he gets that day, and that happens at a much  
5 higher percentage --

6 QUESTION: Well, that would explain why  
7 assessments might be wrong as to individual employees, but  
8 it still doesn't reduce the gross amount in the tip column  
9 on the credit card.

10 MS. POWER: It does reduce the gross amounts --

11 QUESTION: How?

12 MS. POWER: -- that the employer would have to  
13 owe, because if any of that credit card tips that you're  
14 assuming isn't in fact a tip was received by somebody who  
15 made less than \$20 a month, the employer doesn't owe any  
16 tax on that.

17 QUESTION: Okay. That's a possibility, but  
18 wouldn't it suffice on any rule of probability if the  
19 Government did just what Justice Stevens described? It's  
20 quite true, yes, there might have been an extraordinary  
21 turnover, if there is, the employer can come in and say  
22 so. But if the Government made its claim simply based on  
23 what the credit card reports showed, wouldn't the  
24 Government have made an assessment which enjoyed at least  
25 a probability of accuracy?

1 MS. POWER: No, because you go back to 3111 and  
2 Congress did not impose a tax on the aggregate earnings of  
3 all employees collectively.

4 QUESTION: So your argument there is that even  
5 if you had the perfect evidence, even if there was a memo  
6 beyond dispute, written by the accountant and signed by  
7 all the employers that said, after the most thorough  
8 investigation of this restaurant I'm telling you  
9 privately, and you agree, that the total tips earned that  
10 are eligible for social security are \$350,000, so it's  
11 signed by 15 bishops, you know, absolute, dead right,  
12 we're saying that even if that's so, he still doesn't owe  
13 it because in the memo it doesn't say which employees.

14 MS. POWER: I think that it needs to say which  
15 employees learned which amount, and that's what the tax  
16 was imposed upon, and if on the other hand you had all of  
17 the employees say yes, I earned this, yes, I earned this,  
18 yes, I earned this, then you would have that individual  
19 determination.

20 QUESTION: But there's never been anything held,  
21 is there, that where an employer clearly owes a tax to the  
22 Government, based because of the earnings of the employee,  
23 and there can be different contexts where that comes up,  
24 the evidence that he owes that has to name or pick out  
25 which employee? I assume if there were a case that ever



1     said that you would have cited it, and I doubt that there  
2     is.

3             MS. POWER: I don't think that there is.

4             QUESTION: All right. If there isn't, then  
5     that's my problem. If you're talking about the quality of  
6     the evidence, you run into the problem that Justices  
7     Stevens and Souter mentioned. If you're talking about the  
8     need for the precision identification of a single  
9     employee, I don't see in the law any requirement for such  
10    a principle.

11            MS. POWER: I think that it's in 3111. I think  
12    that this Court has already held that the tax is imposed  
13    upon --

14            QUESTION: But whereabouts in 3111? If it's  
15    just two sentences, tell us what sentence or what clause  
16    you --

17            MS. POWER: Well, 3111, it says wages or -- 3111  
18    says wages -- I'm sorry, Your Honor.

19            Equal to the following percentage of wages as  
20    defined in section 3121(a), the tax imposed on something  
21    called wages, that is defined in 3121(a). You cannot read  
22    3121(a) as anything but --

23            QUESTION: Where do we find 3121(a) in your  
24    brief?

25            MS. POWER: It's on the next page, page 56 of

1 the Government's appendix to the petition, and it says,  
2 the term wages means all remuneration for employment, and  
3 it goes on -- they only have one of the individual terms  
4 listed. There are 21 specific --

5 QUESTION: But you're telling us this shows your  
6 point, and you -- point to the language that you think it  
7 does.

8 MS. POWER: 3111 imposes a tax on wages --

9 QUESTION: On wages. It doesn't say  
10 individual -- wages paid to each individual. It says  
11 wages.

12 MS. POWER: It says wages as defined in 3121(a).

13 QUESTION: Then we turn to 3121, and where is it  
14 in there that it makes your point?

15 MS. POWER: When you go through each one of the  
16 21 --

17 QUESTION: Well, that's what we're here for, to  
18 go through something.

19 MS. POWER: Okay, well, the 21 exceptions to  
20 2131(a) lists individual things like whether an employee  
21 participates in a health insurance plan, whether an  
22 employee has a 401(k) plan, the extent to which an  
23 employee's wages go above or below the social security  
24 wage base.

25 QUESTION: But that goes to the accuracy of the

1 figure, perhaps, which you said really is not your point.  
2 That -- none of those exceptions say anywhere,  
3 collectively or in specific terms, that under 3111 you  
4 can't add them all up.

5 MS. POWER: Well, this Court has already held  
6 that --

7 QUESTION: And that's what we're saying.

8 MS. POWER: -- that's not the way the tax works.  
9 This Court has already held in *Flora v. United States* and  
10 as quoted in *Steele v. United States* that it isn't a tax  
11 on the aggregate earnings. It is -- the assessment is an  
12 accumulation of separate, divisible taxes on each  
13 transaction. What is subject to the tax is each  
14 individual payment --

15 QUESTION: There are two *Flora* cases, neither of  
16 which are cited in your brief. Which *Flora* -- there was a  
17 rehearing grant. Which one are you --

18 MS. POWER: *Flora v. United States*, and I  
19 believe it's footnote 37 in *Flora v. United States*.

20 QUESTION: Yes, but there are two *Flora v.*  
21 *United States* that a rehearing was granted, one's 357,  
22 one's 362, and your brief doesn't seem to mention either  
23 of them.

24 MS. POWER: Well, we referenced them in our  
25 complaint, Your Honor. I think it's paragraph 14 of our

1 complaint.

2 QUESTION: Does it give a citation there?

3 MS. POWER: Yes, Your Honor. 362 U.S. 145.

4 QUESTION: But that was just about whether or  
5 not the tax court had jurisdiction if the assessment  
6 wasn't completely paid beforehand, wasn't it?

7 MS. POWER: Yes, but I believe that footnote 37  
8 in that brief, in that opinion said that the Court agreed  
9 that the excise tax, like a FICA tax, is a divisible tax.  
10 That's the whole basis upon which we're here. We only  
11 paid \$18 of the total tax, and we paid it on the basis of  
12 our estimate, although we cannot prove it one way or the  
13 other, of one employee who would have made less than \$20 a  
14 month over a period of time. If this wasn't a divisible  
15 tax, or one that was imposed upon each transaction of  
16 wages, then we would have had to pay the entire \$23,000.  
17 This hold that it is a tax on an accumulation of all wages  
18 of all employees is to change that 40-year history of --

19 QUESTION: Now, Congress passed something called  
20 the TRAC law in 1998 to deal with this very problem of  
21 tips and the FICA tax, did it not?

22 MS. POWER: Not technically, Your Honor. TRAC  
23 is not something that Congress passed. TRAC is something  
24 that is an agreement between the industry and the IRS. It  
25 was -- I was the first person who approached the IRS on

1 coming up with some type of an agreement with the IRS to  
2 solve this problem, and the TRAC agreement was a contract  
3 that was written between --

4 QUESTION: I thought there was a section in 1998  
5 passed by Congress, section 3414 of the Internal Revenue  
6 Service Restructuring and Reform Act providing that IRS  
7 would not threaten a taxpayer audit to coerce the taxpayer  
8 into entering a tip-reporting alternative commitment  
9 agreement, so at least Congress acknowledged --

10 MS. POWER: Congress acknowledged --

11 QUESTION: -- the agreement, did it not?

12 MS. POWER: It acknowledged that the agreement  
13 existed, but Congress --

14 QUESTION: Do you think Congress was assuming  
15 there were assessments going on of employers for this  
16 liability?

17 MS. POWER: Not at that time, because there are  
18 two documents at the very end of the joint appendix that  
19 are Government documents, and they indicate that they were  
20 not doing the employer-only assessments at that time. In  
21 fact, they indicate that they were not doing the employer-  
22 only assessments at that time. In fact, they indicate  
23 that they -- they assured Congress that they were not  
24 doing assessments at that time.

25 QUESTION: When did the IRS start doing these

1 aggregate assessments? Do you know when they started?

2 MS. POWER: I would say that they started doing  
3 them about 1992, 1993, and you had asked the question  
4 earlier, how many TRAC agreements are there that have been  
5 signed. There are about 25-to-30,000 TRAC agreements that  
6 have been signed. There are about 200,000 --

7 QUESTION: Well, this congressional provision  
8 that I asked you about was made in 1998, so that was well  
9 after the beginning of aggregate assessments.

10 MS. POWER: And long after the IRS had announced  
11 that they were not doing aggregate assessments.

12 QUESTION: The gravamen of your brief is that as  
13 a principle an assessment shouldn't be imposed on the  
14 taxpayer unless the taxpayer has the information to  
15 contradict the assessment, which certainly makes a lot of  
16 common sense. Is there a provision in the code, or  
17 something that we've said in the cases that sustains that  
18 overarching principle?

19 MS. POWER: Well, I think that --

20 QUESTION: Or is it just kind of a due process  
21 fairness thing?

22 MS. POWER: Well --

23 QUESTION: Is there a specific principle you can  
24 point to to show the correctness of that assumption?

25 MS. POWER: Well, I think that there's 30 years

1 of congressional history that clearly shows that Congress  
2 does not intend for the employer to be put in this  
3 position, that Congress did not intend for the employer to  
4 be required to police and monitor the reporting of  
5 employees, and ostensibly that's what the IRS'  
6 interpretation does.

7 QUESTION: But you have no specific authority or  
8 precedent for the proposition that an assessment should  
9 not be imposed on a taxpayer unless the taxpayer is in a  
10 good or perhaps best position to contradict the  
11 assessment?

12 MS. POWER: I think that we have plenty of  
13 authority for the proposition that the assessment in this  
14 case is unauthorized because it's on the collective wage-  
15 earning on 31 --

16 QUESTION: But that wasn't what I asked you. I  
17 asked you about the general proposition.

18 MS. POWER: That a tax cannot be imposed upon --

19 QUESTION: An assessment cannot be imposed on  
20 the taxpayer unless the taxpayer has the capacity or the  
21 ability to contradict it. I mean, that's -- it seems to  
22 me that's the principle argument in your brief. It makes  
23 a lot of sense, but I want to know if I'm -- if the  
24 Court's writing an opinion for that, what do they cite for  
25 that proposition?

1 MS. POWER: The best I can tell you --

2 QUESTION: Other than the fact that this is  
3 something everybody should know, but that doesn't usually  
4 work.

5 (Laughter.)

6 MS. POWER: I think that the burden of  
7 presumption and the burden of proof that they have put  
8 forth is premised upon the understanding that the person  
9 with that burden has the records and is in the best  
10 position to respond, and that does not characterize this  
11 situation, so those policy considerations behind that are  
12 not existing here.

13 QUESTION: Are there other situations in the tax  
14 law where the Government knows that income has been  
15 underreported? Aren't estimates made in many different  
16 contexts where the taxpayer doesn't keep reliable records,  
17 and so the Government has to find some way of measuring  
18 what the tax should be, so it does an estimate? Isn't  
19 that common?

20 MS. POWER: In each one of those cases it's --  
21 the person responsible for keeping the records is the one  
22 taxed. We have no problem with the IRS attempting to  
23 determine the earnings of the individual employees and  
24 coming back and --

25 QUESTION: Well, you did before, because when I



1     asked you, are they making an estimate in that case, and  
2     you started to say no, because the taxpayer, the  
3     individual servers have all these --

4             MS. POWER:   Excuses --

5             QUESTION:   Yes.

6             MS. POWER:   -- or defenses?

7             QUESTION:   Yes.   But I thought that they  
8     could -- I thought that was a given, that if they go after  
9     a single waiter, that they can have an estimate.

10            MS. POWER:   They can.

11            QUESTION:   They do make an estimate.

12            MS. POWER:   They can.

13            QUESTION:   And the very estimate that you are  
14     resisting when it applies to the employer.

15            MS. POWER:   Because we are -- we don't have the  
16     same defenses that the waiter and the waitress does.   The  
17     waiter and the waitress can say, you know, all kinds of  
18     things in response, that no, I didn't earn that, here are  
19     my records, here are my individual records of exactly what  
20     I earned.

21            The IRS sends them a bill based on the same  
22     types of estimates, takes it one step further and says,  
23     okay, well, you worked X number of hours out of the total  
24     number of hours in this restaurant, so of this total share  
25     we think your share is this amount.   The waiter or

1 waitress can come in and say no, here's my individual  
2 record, and this is exactly what I earned, or no, you're  
3 wrong in assuming this, or you're wrong in assuming that,  
4 and then a determination can be made of what that  
5 individual waiter or waitress made, and then turn around  
6 and give it to us.

7 That's exactly what one of the documents in our  
8 joint appendix on page 92, that's exactly what the IRS did  
9 do before they came up with this aggregate assessment  
10 method, because that is precisely what Congress envisioned  
11 that the IRS would be doing with the 8027 Form data, is  
12 taking that information, using that information to make  
13 examinations of individual employees, and then turning  
14 around --

15 QUESTION: Now, practically can the IRS -- are  
16 you suggesting that they go after the employees, and then  
17 when they know the amount based on the extra tax the  
18 employee will have to pay, then say, okay, employer, you  
19 pay the same amount, but practically can the IRS -- does  
20 it have the facilities to go audit every waiter and busboy  
21 and --

22 MS. POWER: There's no requirement that they  
23 audit every waiter or busboy. In the first place, that  
24 letter that I just pointed out didn't require any audit at  
25 all, and not only that, in the context of what's happening

1 here, they still have an audit problem. They've only  
2 collected, or are attempting to collect 25 cents out of  
3 every single dollar. They're leaving three -- 75 cents on  
4 the table here. They come in here and they say that  
5 they've got this huge, astronomical problem, and we can't  
6 do anything about it.

7 QUESTION: Well, the reason is, maybe it isn't  
8 cost-effective to go after the individual employees.

9 MS. POWER: Well, I don't think it's very cost-  
10 effective to do this one, when the employer is --

11 QUESTION: The employer tax is owed  
12 independently, which is what I started to ask you about  
13 when you gave your cow example. The taxes on an employer,  
14 that's a discrete tax. There's a tax on the employee.  
15 That's a discrete tax. Why, because the Government is  
16 going to have a hard time collecting the tax on the  
17 employee, is it disabled from collecting the tax on the  
18 employer?

19 MS. POWER: Because that's what Congress said --

20 QUESTION: Thank you, Ms. Power.

21 MS. POWER: -- that the IRS should do.

22 QUESTION: Ms. O'Connor, you have 3 minutes  
23 remaining.

24 REBUTTAL ARGUMENT OF EILEEN J. O'CONNOR

25 ON BEHALF OF THE PETITIONER

1                   QUESTION: Ms. O'Connor, at the very outset you  
2   said that 311 imposed a tax on wages paid or deemed to  
3   have been paid. Is the word deemed in the statute?

4                   MS. O'CONNOR: Is the word deemed in the  
5   statute?

6                   QUESTION: Yes.

7                   MS. O'CONNOR: I believe so. I believe it's in  
8   3121(q), Your Honor, which I keep losing.

9                   QUESTION: Well, I'll find it.

10                  MS. O'CONNOR: Yes, it's on page 58a, is where  
11   3121(q) appears, and remember that is a section that  
12   provides definitions. 3121 tells you that wages include  
13   tips which are paid or deemed to have been paid, and  
14   3121(q) also tells you the time.

15                  As we have said, this is a tax on an aggregate  
16   amount. Form 941 in your joint appendix show how the  
17   employer reports the tax, and shows that it is a tax on  
18   the wages paid.

19                  QUESTION: Well, except I think the deeming  
20   refers to the time of payment, not to the fact of payment,  
21   but I'll look at that.

22                  MS. O'CONNOR: I think you're right about that,  
23   Your Honor. Nonetheless, they are deemed to be paid at  
24   the time, right. 3121(q) tells you that tips are  
25   included, and then the deemed part is -- the tips are

1 wages, and the deemed part is when they are deemed to have  
2 been paid. They're deemed to have been paid by the  
3 employer, and then it goes on and tells you when. It does  
4 say tips are deemed to have been paid by the employer.  
5 That's the very first sentence. It's at page 85a.

6 QUESTION: How long has IRS been making these  
7 assessments, please, Ms. O'Connor?

8 MS. O'CONNOR: I believe, Justice O'Connor, that  
9 it did start around 1992 and 1993, and the information  
10 that the IRS is gathering on the forms 8027 demonstrated  
11 the extent of the problem that Congress suspected did  
12 exist about substantial underreporting of tip income.

13 QUESTION: In view of all the questions about  
14 the proper computation, why has the Government resisted  
15 notice and comment rulemaking to come up with a fair  
16 formula, because the contention is that the Government's  
17 formula exaggerates the income, exaggerates the tip  
18 income.

19 MS. O'CONNOR: That is certainly the contention,  
20 and there have been, however, no facts to show whether  
21 that's true or not, because in each of the cases, not only  
22 the Ninth Circuit below, but in each of the three cases  
23 that we cite in our briefs decided by the Seventh,  
24 Eleventh, and the Federal Circuits, no evidence was ever  
25 submitted to show that the tips were overstated in any

1 way.

2 QUESTION: But why not -- why not employ that  
3 fair procedure of going through the notice and comment,  
4 and then -- I think that's what Judge Kozinski said to do.

5 MS. O'CONNOR: Yes, he did. Judge Kozinski's  
6 opinion entirely excludes section --

7 CHIEF JUSTICE REHNQUIST: I think you've  
8 answered the question. Judge Kozinski did say that, so  
9 the case is submitted.

10 (Whereupon, at 11:03 a.m., the case in the  
11 above-entitled matter was submitted.)

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