Note

FICA—FRUSTRATION OF PRIVATE SECTORS RETIREMENT PLANNING INITIATIVES

I. Introduction

For many years, the Treasury Department and the Internal Revenue Service (IRS) issued regulations and rulings which defined wages for purposes of income tax withholding differently than for purposes of Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) tax withholding. In Rowan Cos. v. United States, the Supreme Court invalidated one such regulation, holding that wages should be defined similarly for FICA, FUTA, and income tax withholding. Congress then acted to explicitly define wages differently for the three purposes.

Meanwhile, relying on Rowan, Temple University challenged an IRS ruling which defined certain contributions to tax-deferred annuity plans as wages for FICA purposes although such contributions were not wages for income tax withholding purposes. The Third Circuit Court of Appeals looked to the legislative history of the new provisions and upheld the older revenue ruling by finding it to be consistent with congressional intent.

This note will trace the development of the definitions of wages that resulted in the clear Rowan standard. It then will focus on the Temple decision and question the court’s reliance on recent legislative history as a basis for upholding a fourteen-year-old ruling. The author will also question the constitutionality of tax legislation that was made retroactive to a period beginning before its legislative session.

Finally, the note will discuss the negative impact that the new FICA provisions will have on voluntary employee retirement plans and will call for Congress to return to the simpler and more effective rule of Rowan.

5. Id. at 129-30.
II. Background

A. Pre-Rowan Developments

The question in the Rowan case involved the status, for FICA purposes, of employer-provided meals and lodging. The value of meals and lodging provided by an employer for his convenience are excluded from the gross income of an employee.6 This exclusion applies only to meals in kind and not to cash allowances.7

The Supreme Court, however, in Central Illinois Public Service Co. v. United States8 determined that for the purposes of federal income tax withholding, the definition of wages did not include reimbursement for meals by an employer. This was found despite the potential includability of the reimbursements in the gross income of the employee.9 The Court held:

An expansive and sweeping definition of wages . . . is not consistent with the existing withholding system. As noted above, Congress chose simplicity, ease of administration, and confinement to wages as the standard in 1942. This was a standard that was intentionally narrow and precise . . . it is a matter of obvious concern that, absent further specific congressional action, the employer’s obligation to withhold be precise and not speculative.10

In Hotel Conquistador, Inc. v. United States,11 the court of claims was confronted with the issue of whether employer-provided meals constituted wages for the purposes of FICA and FUTA tax withholding. The government argued that since wages and income could be defined differently, wages could be defined more broadly to include some items not included in income.12

---

9. Id. at 29. The Court added, "[I]t is one thing to say that the reimbursements constitute income to the employee for income tax purposes, and it is quite another thing to say that it follows therefrom that the reimbursements . . . were subject to withholding." Id.
10. Id. at 31.
11. 597 F.2d 1348 (Ct. Cl. 1979).
12. Id. at 1350.
Although the court pointed out that the government's position was not supported by the Supreme Court's Central Illinois decision, which had defined wages as a subset of income, the court of claims declined to decide the issue on that basis.13

Instead, the court focused on the definition of wages as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash."14 Finding that the meals constituted a relatively small part of the employee's remuneration package and that these meals were provided primarily to aid in implementing other company policies, the court found that these employer-provided meals could not be classified as remuneration and, therefore, were not wages for FICA or FUTA purposes.15

In Oscar Meyer & Co. v. United States,16 the Seventh Circuit Court of Appeals considered the question of whether the unreimbursed value of personal use of company automobiles constituted wages for FICA and FUTA purposes. In its discussion, the court relied on three factors. First, it adopted the Central Illinois holding that since Congress intended simplicity and ease of administration in the withholding legislation, wages should be defined narrowly.17 Next, the court noted that in creating withholding requirements, Congress used the identical term "wages" as the basis for all three kinds of withholding taxes.18 Since Congress also defined wages similarly in all three instances, the court inferred that Congress intended to apply the same general concepts to all three taxes.19

Finally, the Seventh Circuit pointed out that although Hotel Conquistador was decided upon the definition of "remuneration," the court of claims had not suggested that wages for the purposes of FICA and FUTA withholding would differ from wages for the purposes of federal income tax withholding.20 Thus, the Oscar Meyer court concluded that Congress intended that wages be defined similarly for FICA, FUTA, and federal income tax withholding purposes.21

13. Id. at 1350, 1351.
14. Id. at 1350.
15. Id.
16. 623 F.2d 1223 (7th Cir. 1980).
17. Id. at 1225.
18. Id. at 1225-26.
19. Id.
20. Id.
21. Id.
B. The Rowan Decision

As a result of an audit, the Rowan Companies challenged the validity of Treasury Regulations which required FICA\(^2\) and FUTA\(^3\) taxes to be withheld on the value of employer-provided meals and lodging.\(^4\) Relying on the aforementioned cases, Rowan argued that since the value of the meals and lodging was not included in wages for the purposes of federal income tax withholding, neither should that value be included in wages for the purposes of FICA or FUTA withholding.\(^5\) The Fifth Circuit, however, upheld the Treasury Secretary's right to interpret the similar language differently, in light of the varying "purposes of the statutes, the uses made of their revenues and their relationship with other statutes."\(^6\)

Because the Fifth Circuit Court of Appeals in Rowan was in

\(^{22}\) Treas. Reg. § 31.3121(a)-1(f) (1980) provides:
Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. The term "facilities or privileges," however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.

\(^{23}\) Treas. Reg. § 31.3306(b)-1(e) & -1(f) (1980) provides:
(e) Except in the case of remuneration paid for services not in the course of the employer's trade or business (see § 31.3306(b)(7)-1), the medium in which the remuneration is paid is also immaterial. It may be paid in cash or in something other than cash, as for example, goods, lodging, food, or clothing. Remuneration paid in items other than cash shall be computed on the basis of the fair value of such items at the time of payments.

(f) Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. The term "facilities or privileges," however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.

\(^{24}\) Rowan, 452 U.S. at 249-50.
\(^{25}\) Id. at 250.
\(^{26}\) Id.
conflict with prior decisions in other circuits, the Supreme Court granted certiorari. The Court applied a “plain language of the statute” approach and so found that the statutory definitions of wages for income tax withholding, FICA, and FUTA are substantially the same. The Court examined the legislative history of the acts and determined that in the absence of express language otherwise, wages should be defined the same for all three purposes:

In sum, Congress intended in both the Revenue Act of 1942 and the Current Tax Payment Act of 1943 to coordinate the income tax withholding system with FICA and FUTA. In both instances, Congress did so to promote simplicity and ease of administration. Contradictory interpretations of substantially identical definitions do not serve that interest. It would be extraordinary for a Congress pursuing this interest to intend, without ever saying so, for identical definitions to be interpreted differently.

The Court concluded that regulations which interpret the definition of wages inconsistently for income tax withholding and for FICA and FUTA purposes are contrary to congressional intent and are therefore invalid.

C. The Temple Decision

On the strength of the Rowan decision, Temple University filed

28. I.R.C. § 3401(a) (amended 1984) provides: “(a) WAGES.—For purposes of this chapter, the term “wages” means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration [including benefits] paid in any medium other than cash . . . .”
29. I.R.C. § 3121(a) (1984) provides: “(a) WAGES.—For purposes of this chapter, the term “wages” means all remuneration for employment, including the cash value of all remuneration [including benefits] paid in any medium other than cash . . . .”
30. I.R.C. § 3306(b) (1984) provides: “(b) WAGES.—For purposes of this chapter, the term “wages” means all remuneration for employment, including the cash value of all remuneration [including benefits] paid in any medium other than cash . . . .”
31. Rowan, 452 U.S. at 255. The only difference between the statutory definitions is that wages are defined as “renumeration [sic] for services performed by an employee for his employer” for income tax withholding purposes and as “remuneration for employment” for FICA and FUTA purposes.
32. Id. at 257.
33. Id. at 263.
claims for refunds for the years 1979 through 1982 for the amount of FICA tax withheld on voluntary salary reduction amounts used by employees to contribute to tax-deferred annuities.\textsuperscript{34} A tax-deferred annuity plan is a retirement plan permitted by statute\textsuperscript{35} for employees of specific nonprofit corporations and public schools.\textsuperscript{36} Additions to the plans may take the form of employer contributions used to purchase annuities for participating employees.\textsuperscript{37} These contributions are statutorily exempt from wages for FICA withholding purposes.\textsuperscript{38} But, as in the instant case, additions to the plan may be in the form of salary reductions agreed to in advance by the employees.\textsuperscript{39} These amounts are voluntary contributions on the part of the employees and subject to limits consistent with other tax-favored retirement plans.\textsuperscript{40}

The treatment of these reduction amounts for FICA purposes followed an historical pattern similar to employer-provided meals before \textit{Rowan}. The Treasury Department promulgated regulations which defined wages for FICA purposes as including employer-provided meals.\textsuperscript{41} Revenue Rulings on both questions were issued which were consistent with the Treasury position that wages for FICA purposes could include remuneration amounts which were exempt from wages for federal income tax withholding purposes.\textsuperscript{42}

After the \textit{Rowan} decision, however, Congress had taken action to clarify the definitions of wages.\textsuperscript{43} The Social Security Amendments of 1983 had codified the final result in \textit{Rowan} by excluding from FICA wages the value of certain employer-provided meals and lodging.\textsuperscript{44} But in the same Act, Congress rejected the underlying reasoning

\begin{itemize}
\item \textsuperscript{34} \textit{Temple}, 769 F.2d at 128.
\item \textsuperscript{35} I.R.C. \textsection{} 403(b) (1958).
\item \textsuperscript{36} I.R.C. \textsection{} 403(b)(1) provides plan participation for employees of tax-exempt organizations described in I.R.C. \textsection{} 501(c)(3) and for employees of educational organizations described in I.R.C. \textsection{} 170(B)(1)(A)(ii).
\item \textsuperscript{37} Id. \textsection{} 403(b).
\item \textsuperscript{38} Id. \textsection{} 3121(a)(5)(D) (amended 1984).
\item \textsuperscript{39} Treas. Reg. \textsection{} 1.403(b)-1(b)(3).
\item \textsuperscript{40} I.R.C. \textsection{} 403(b)(2) (1958).
\item \textsuperscript{41} See supra note 22 (Treas. Reg. \textsection{} 31.3121(a)-1(f)).
\item \textsuperscript{44} Pub. L. No. 98-21, \textsection{} 330 (1980) (amended I.R.C. \textsection{} 3121(a)(19)) provides that for purpose of the FICA chapter, wages shall not include "the value of any meals or lodging furnished by or on behalf of the employer if at the time of such
in *Rowan* by explicitly amending the definition of FICA wages to include voluntary salary reduction contributions to tax-deferred annuity plans, although these contributions were excluded specifically from the definition of income tax wages. Then, in early 1984, Congress gave retroactive effect to the provision which required FICA wages to include the voluntary salary reduction contributions to tax-deferred annuities.

Since the tax years in controversy were 1979-1982, Temple argued that the Supreme Court's reasoning in *Rowan* should control so that contributions to tax-deferred annuities would not be subject to FICA withholding. The Third Circuit Court of Appeals, however, held that the broad holding of *Rowan* was effectively overruled by the Social Security Amendments of 1983. The court further rejected Temple's argument that the retroactive effect of the Deficit Reduction Act of 1984 was unconstitutional. After examining pertinent legislative history for both acts, the Temple court concluded that: (1) the intent of Congress always had been to define wages for FICA purposes as including voluntary salary reduction amounts to tax-deferred annuity plans; and (2) the distinction between the definition of federal income tax wages and FICA wages is justified by the differing objectives of the legislation creating such withholding. In reaching these conclusions, the Temple court limited its examination of legislative history to that legislation passed subsequent to both *Rowan* and the tax years in controversy.

---

furnishing it is reasonable to believe that the employee will be able to exclude such items from income under section 199 . . . ."

45. Pub. L. No. 98-21 § 324(a)(2) (amended I.R.C. § 3121(a)(5)(E)) provides that wages for FICA purposes shall not include "(5) any payment made to, or on behalf of, an employee or his beneficiary— . . . (E) under or to an exempt governmental deferred compensation plan (as defined in subsection (v)(3)) . . . ." This provision was specified to apply to contributions after December 31, 1983.


47. Pub. L. No. 98-369, § 2662(g) (1984). It applies to "remuneration paid after March 4, 1983, and to any such remuneration . . . paid on or before such date which the employer treated as wages when paid." Id.


49. Id. at 133.

50. Id. at 134-35. Temple argued that the retroactive provisions violated both due process and equal protection. See infra notes 75-82 and accompanying text.

51. *Temple*, 769 F.2d at 130 & 131 n.3.

52. Id. at 130. See also H.R. REP. No. 25, 98th Cong., 1st Sess. 2 (1983), reprinted in 1983 U.S. CODE CONG. & AD. NEWS 219. The purpose of social security to provide income replacement differs from the revenue-producing purpose of income tax. Therefore, the differing objectives permit the exempt wages from federal income tax to be includable in wages for social security.
III. Analysis

A. The Temple Result is Contrary to the Express Language of Rowan

In reaching its result, the Rowan Court was forced to resolve issues which were either similar or identical to those in Temple. The validity of regulations and rulings which defined wages for the purposes of federal income tax differently from those of FICA had been questioned. The Rowan conclusion would appear to be controlling in the Temple case. In fact, commentators following the Rowan case expected that the result would be read broadly to provide symmetrical treatment of other compensation provisions for both FICA and federal income tax withholding purposes.53 Yet, the Temple court chose to distinguish Rowan for the purposes of salary reduction amounts contributed to tax-deferred annuity plans.54

The Rowan Court thoroughly analyzed the challenged Treasury regulations. Generally, Treasury regulations fall into two categories: (1) regulations promulgated under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision; and (2) regulations promulgated under the general grant of authority to prescribe all needful rules and regulations.55 Since the regulations defining wages fall into the latter category, the courts owe them less deference than those of the former.56 The Supreme Court in United States v. Correll57 concluded that regulations must be treated with deference if they implement the congressional mandate in some reasonable manner.58 The factors which must be considered in determining whether this test is met by a Treasury regulation were stated by the Court in National Muffler Dealers Association v. United States:59

[W]e look to see whether the regulation harmonizes with

54. Temple, 769 F.2d at 135.
56. Rowan, 452 U.S. at 253.
58. Id. at 307.
The plain language of the statute, its origin, and its purpose. A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent. If the regulation dates from a later period, the manner in which it evolved merits inquiry. Other relevant considerations are the length of time the regulation has been in effect, the reliance placed on it, the consistency of the Commissioner's interpretation, and the degree of scrutiny Congress has devoted to the regulation during subsequent reenactments of the statute.60

The Rowan Court considered many of those factors in reaching its conclusion. First, it was shown that the statutes defining wages for income tax withholding and FICA purposes are substantially identical by their plain language.61 Second, it was concluded that the regulations in question were not substantially contemporaneous to the construction of the statute and were a proper subject for court inquiry.62 Third, the Court examined the legislative history of income tax withholding provisions and found that Congress was concerned with "the interest of simplicity and ease of administration" in these provisions.63 The Court then indicated that "one of the means Congress chose in order to promote simplicity was to base withholding upon the same measure—'wages'—as taxation under FICA and FUTA."64

Fourth, the Court found that the Treasury regulations and rulings on this question lacked consistency over time.65 Finally, the Court's inquiry revealed no evidence of congressional consideration of the various regulations and rulings at the time the statutes were reenacted.66

The petitioner's premise in Rowan was that Congress intended that wages be defined identically for FICA, FUTA, and income tax

60. Id. at 477.
61. Rowan, 452 U.S. at 252. See supra notes 28 (income tax) and 29 (FICA) for statutory definitions.
63. Id. at 255 (citing S. Rep. No. 1631, 77th Cong., 2d Sess. 165 (1942)).
64. Id.
65. Id. at 258-59.
66. Id. at 262. In fact, the issue was not considered directly by Congress until the Social Security Amendments of 1983, Pub. L. No. 98-21 (1983), where Rowan was codified so as to be limited to employer-provided meals.
withholding purposes.\textsuperscript{67} After careful scrutiny, the \textit{Rowan} Court declared the challenged regulations invalid by stating:

The plain language and legislative history of the relevant Acts indicate that Congress intended this definition to be interpreted in the same manner for FICA and FUTA as for income-tax withholding. The Treasury Regulations on which the government relies fail to do so, and their inconsistent and unexplained application undermine the intention that Congress nonetheless endorsed them.\textsuperscript{68}

Since the express language of \textit{Rowan} seemed clear, the taxpayer in \textit{Temple} argued, albeit unsuccessfully, that it was controlling.

In \textit{Temple}, the court examined the validity of an IRS Revenue Ruling which had interpreted a FICA provision.\textsuperscript{69} Revenue rulings are "for the information of taxpayers and their counsel as showing the trend of official opinion in the administration of the Bureau of the Internal Revenue; the rulings . . . have none of the force or effect of Treasury Decisions."\textsuperscript{70} And yet, in determining congressional intent, the Third Circuit adopted the language of a revenue ruling rather than the clear language of the Supreme Court in \textit{Rowan}.

The \textit{Temple} court based its conclusion upon the legislative histories of both the Social Security Amendments of 1983 and the Deficit Reduction Act of 1984.\textsuperscript{71} While \textit{National Muffler Dealers} indicated that an examination of legislative history is relevant in the judicial scrutiny of a Treasury ruling, it is only one of several factors to be considered.\textsuperscript{72} The \textit{Temple} court, however, gave no consideration to the other factors discussed at length in \textit{Rowan}.

It also appears odd that the Third Circuit chose to base its decision on legislative history for statutes which were enacted several years after the ruling was issued and ignored the legislative history

\begin{footnotesize}
\footnotetext{67} \textit{Rowan}, 452 U.S. at 254-55. \footnotetext{68} Id. at 263. \footnotetext{69} Rev. Rul. 65-208, 1965-2 C.B. 383, which provided in part:
[T]he amounts used by the organization pursuant to the salary reduction agreement to purchase the annuity for the employee are "wages" for purposes of the Federal Insurance Contributions Act, even though such amounts, within prescribed limits, are includable from the employee's gross income for purposes of Sec. 403(b) of the code. \footnotetext{70} \textit{Statement of Principles of Internal Revenue Tax Administration} found in front of each Cumulative Bulletin. See, e.g., 1984-3 C.B. iii. \footnotetext{71} \textit{Temple}, 769 F.2d at 130-32. \footnotetext{72} See supra note 58 and accompanying text.}
\end{footnotesize}
for the statute in place at the time the ruling in question was promulgated. 73 Although the Rowan Court had found that the Conference Committee’s report for the Act of 1942 limited the scope of wages in the interest of simplicity and ease of administration,74 the Temple court did not use that finding. The Rowan Court also unambiguously determined that the legislative history behind the withholding statutes indicated the congressional intent to define wages consistently for both federal income tax withholding and FICA withholding.75

The Third Circuit, however, rejected these Supreme Court determinations by finding that when Congress amended the statutes in 1983 and 1984 to codify the revenue ruling, Congress was merely clarifying what had been its intent all along.76 Thus, the court determined that 1983 legislative history was more accurate than 1942 legislative history in determining 1942 congressional intent. Surely, very little weight should be given to congressional discussion forty years after the legislation, especially when there existed clear Supreme Court interpretation based upon contemporaneous legislative history. Thus, the Temple court was unjustified in ignoring the clear language of Rowan.

B. The Retroactive Impact of the Social Security Amendments of 1983 was Unconstitutional

The court in Temple concluded that Congress acted within constitutional authority by applying the Social Security Amendments of 1983 retroactively to the provisions of the Deficit Reduction Act of 1984.77 In reaching this conclusion, the court found that the statute survived taxpayer’s due process challenge,78 because the retroactive

75. Id. at 257.
76. Temple, 769 F.2d at 130, 131 n.3.
77. Id. at 135.
78. Temple also argued that the retroactive provision violated the equal protection clause. Since only employers who withheld FICA taxes are specifically mentioned in the statute, Temple asserted that Congress improperly favored employers who had not complied with the revenue ruling. The court rejected this argument, however, claiming that Congress did not foreclose the IRS from suing
imposition of the tax was neither arbitrary nor unfair. 79

The Third Circuit correctly stated that the retroactive imposition of taxation is not per se violative of due process.80 However, as noted in the dissent, the retroactive imposition of a tax extending back to a period several years prior to the statute is unprecedented. 81 The test applied by the Temple court was fashioned in Wilgard Realty Co. v. Commissioner. 82 The Temple court concluded that since the 1984 Act was neither arbitrary nor oppressive, it was constitutional.

Although not explicitly barred by federal court precedent, the retroactive imposition of a tax beyond a short period previously had not been validated by a federal court. The Supreme Court also has indicated that the constitutional authority to impose retroactive taxation exists in periods recent to the enactment of the statute. 84

Since retroactively applying a tax statute as much as five years prior to the enactment moves beyond mere extrapolation from prior law, more attention should be given to the question of whether the time period was, in fact, reasonable. Although the Temple court concluded that it was not unreasonable, further examination by other courts may reveal that five years is an unreasonable time period after which to impose further tax liability, so that the provision may yet be found to violate due process.

C. Current FICA Provisions Frustrate the Efforts of the Private Sector in Retirement Planning.

The legislative history of the Social Security Amendments provides a clear picture that Congress now intends to include all vol-

---

79. Temple, 769 F.2d at 135.

80. Id. at 134. See also Welch v. Henry, 305 U.S. 134 (1938).

81. Temple, 769 F.2d at 139 (Weis, J., dissenting).

82. 127 F.2d 514 (2d Cir. 1942). The Wilgard Realty court stated that "retroactive taxation is not so arbitrary and oppressive as to be unconstitutional if it is no more burdensome than the taxpayer should have expected it to be . . . whether the period of retroactivity is comparatively long or short is of little consequence provided it isn't too long to be within reason." Id. at 517.

83. Temple, 769 F.2d at 135.

84. See Welch v. Henry, 305 U.S. 134, 150 (1938) (retroactive taxation limited to recent transactions); United States v. Hudson, 299 U.S. 498, 500 (1936) ("[I]t long has been the practice of Congress to make [income tax statutes] retroactive for relatively short periods . . . while the statute was in process of enactment . . . .")
untary salary reduction contributions to private retirement plans in
the definition of FICA wages. The legislative history which was a
basis for the Temple decision states:

Under cash or deferred arrangements, certain tax-sheltered annuities . . . the employer contributes funds which are set aside by individual employees for individual savings arrangements, and thus, the committee believes that such employer contributions should be included in the FICA base, as is the case for IRA contributions. Otherwise, individuals could, in effect, control which portion of their compensation was to be included in the social security wage base. The original purpose of Congress in enacting social security was to "relieve the existing distress . . . reduce destitution and dependency in the future." The Temple decision and the Social Security Amendments of 1983 are consistent with this purpose. They provide a larger wage base for affected employees which in turn provides a larger potential benefit from the program. Otherwise, an individual employee would be able to partially elect out of the system by increasing the voluntary salary reduction amounts contributed directly to his retirement plan. However, the social security sword cuts both ways in this case. For every contribution to FICA from these salary reduction amounts, there is an equivalent reduction in the additions to the private retirement plan.

A look at the legislative history of the statutes creating private tax-deferred retirement plans reveals a purpose similar to that of social security. The government created the plans on a tax-favored basis to encourage the development of private plans.

The statutory requirements of tax-deferred annuity plans are consistent with retirement planning objectives. Retirement funds are typically accumulated through deferral of wages from the working years or from a systematic savings program. The funds should be

86. Id. Cash or deferred arrangements are a type of retirement plan established in accordance with I.R.C. § 401(k). IRA plans are individual retirement plans established by I.R.C. § 408.
89. Id.
secure during the accumulation period to ensure their availability for retirement needs. The contributions to a tax-deferred annuity salary reduction plan represent the decision of an employee to forego current receipt of income in favor of providing for later retirement needs. The contributions to the plan must be nonforfeitable by the employee.\textsuperscript{90} The plan cannot be designed merely as a tax shelter for highly-compensated employees since contributions to the plan must be limited in amounts similar to other tax-favored retirement plans.\textsuperscript{91} And, as with qualified retirement plans, income tax laws allow contributions to be made and to accumulate tax-free until actual withdrawal.\textsuperscript{92} The government elected to provide tax incentives for the establishment of individual retirement savings programs, but mysteriously chose to reduce the contributions to these programs by including the contributory amounts in the definition of wages for FICA purposes.

In consideration of this problem, it has been suggested that most compensation, including fringe benefits, be included in the FICA wage base under the insurance theory of social security.\textsuperscript{93} Under this theory, an unemployed or retired worker would lose all remuneration, including fringe benefits, when severing employment. A social security program would better insure all of the lost remuneration if the wage base reflected total remuneration. The holding in \textit{Temple} and the Social Security Amendments of 1983 are consistent with this theory. They provide for full social security insurance coverage of voluntary employee retirement savings contributions. But they do so at the cost of reducing the voluntary retirement savings of an individual. This seems inconsistent with the purpose of the program.

The impact of the \textit{Temple} decision and the 1983 Amendments on the private sector was not addressed by Congress. The reduction of the tax-deferred annuity contributions by the amount of FICA tax could have a substantial impact on the amount of benefits available at retirement to a plan participant. For example, a typical worker, aged thirty-five, who is earning the wage base in 1985 will forego nearly $73,000 from his tax-deferred annuity savings in favor of

\textsuperscript{90} I.R.C. § 403(b)(1)(C) (1958).
\textsuperscript{91} Id. § 403(b)(2)(A). See also § 415 for limits to qualified plans.
\textsuperscript{92} Id. § 403(b)(1).
social security tax by the time the worker retires. This frustrates
the participant’s efforts to provide a private retirement fund even if
the participant is willing to increase his contributions to the plan by
voluntarily reducing current compensation. It has been observed that
this tax disincentive might reduce enrollment in or contributions to
tax-deferred savings plans.

The disincentives mentioned above come at a time of uncertainty
for the social security system. The 1983 amendments indicate a
concern of Congress for the financial integrity of the system. With
more changes likely in the future, it is obvious that a substantial
private retirement program will be helpful, if not essential, to typical
retirees. It has been noted that retirement planners faced with these
changes will need to adjust current thinking toward income replace-
ment objectives and the integration of private plans with social
security.

Thus, rather than codifying Temple, Congress should have re-
turned to the rule in Rowan. If wages were defined identically for
FICA, FUTA, and income tax withholding purposes, the voluntary
contributions to tax-deferred annuities would not be subject to FICA
since they are exempt from income tax withholding. This would
encourage, rather than discourage, employee contributions and would
reduce dependence upon the social security system. It also would
simplify the administration of the withholding provisions since the
same items would be treated identically for all three purposes. Since
the Rowan rule would meet the congressional goals of promoting
simplicity, ease of administration, and employee contributions to tax-
deferred annuities, Congress should reconsider its 1983 and 1984

94. This statement assumes that the worker will continue to earn the current
wage base throughout his working life, that he will retire at age 65, and that the
plan will invest its assets at ten percent annual return. If the wage base, the worker’s
earnings, and the social security tax rate increase (a likely situation), the results
become even more dramatic. In fact, the Temple employees lost $690,584 from
the 403(b) plan to social security tax in the 1979-1982 period alone. Temple, 769
F.2d at 127.

95. Allen, Can Social Security and the Private Pension System Still Coexist, 122
Some observers, however, point out that imposing a Social Security tax on
these amounts could have a negative effect: This additional tax will
reduce the amount of the after-tax gain to the employee and, as a result,
might make the choice of salary reduction less attractive. An employee
might choose not to participate in this part of the program, or to participate
at a lower level.

Id. at 14.

96. Id. at 15.
provisions and amend the tax code to provide for identical treatment of wages for FICA, FUTA, and income tax withholding purposes.

IV. Conclusion

The wisdom of Congress' new FICA legislation is questionable. The legislative histories of the 1983 Social Security Amendments and 1984 Deficit Reduction Act clearly indicate that Congress does not wish to define wages similarly for FICA, FUTA, and income tax withholding. Congress took this step despite the nearly identical statutory language of these three provisions and despite the Supreme Court's clear holding in Rowan that similarly applying the three definitions promoted the congressional goals of simplicity and ease of withholding administration.

There are two basic problems in the new FICA legislation. First, serious doubts arise as to the constitutionality of a tax provision which is made retroactive to a period earlier than the start of its legislative session. Although the Temple majority dismissed this due process challenge, another court might very well find that the retroactive provision was unreasonable, arbitrary, and unfair.

Also, defining wages so that FICA tax will be withheld from voluntary salary reduction contributions to tax-deferred annuity plans will discourage employee participation in these retirement savings plans. Although Congress has set up these plans to allow employees to forego current income in favor of retirement savings, FICA will be withheld from these contributions. As a result, employees will set aside less for savings in order to pay the FICA tax on the contributions.

Therefore, Congress should return to the standard of Rowan. Wages should be defined identically for FICA, FUTA, and income tax withholding. Not only would this rule support the congressional goal of promoting simplicity and ease of withholding administration, but it would also encourage another congressional goal—participation in private retirement plans.

Theodore T. Kurlowicz

*At the time of this publication, the Joint Committee on Taxation has proposed reversing the past legislative trend in order to move toward increasing conformity between the definitions of wages for income tax and wages for FICA purposes. Joint Committee on Taxation, 99th Cong., 1st Sess., Tax Reform Proposals: Compliance and Administration 85 (1985).