



2-2010

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### Recommended Citation

Pannese, D. A. (2010). Court of Federal Claims upholds additional SUI credit. *Journal of Accountancy*, 209(2), 58-59.

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## Court of Federal Claims Upholds Additional SUI Credit

**BY DANNY A. PANNESE, CPA/ABV/CFF, MST, CVA, CSEP**

February 1, 2010

In an unreported decision, the U.S. Court of Federal Claims held that plaintiffs in 10 consolidated tax refund cases were entitled to an additional state unemployment insurance (SUI) credit against their FUTA tax liabilities for years 1991–1996.

Although the case selected as the lead was that of Cencast Services LP, the opinion and an earlier decision set forth the facts of another co-plaintiff, E.P. Talent Services LP (E.P.), as representative of the plaintiffs as a whole. E.P. entered into agreements with production workers to provide payroll services as well as place the workers on projects at various film production companies. The workers submitted records to E.P. showing the amount of time they worked at each production project. E.P. paid the workers out of its own funds and was later reimbursed by the production companies. In addition, E.P. handled all payroll filings as well as withholding and paying FICA and FUTA taxes. The employees' earnings from the production projects were aggregated for FICA and FUTA tax purposes.

The underlying dispute in this case was addressed in a 2004 Court of Federal Claims decision (*Cencast Services LP et al. v. U.S.*, 62 Fed. Cl. 159). In it, the court held that although the plaintiffs were the statutory employers, the common-law employers were the various production companies that engaged the employees. The fact that E.P. contracted the workers was not sufficient to prove it was the employer for FICA and FUTA purposes. The IRS took the position that E.P. could not aggregate employees' wages in applying the FICA and FUTA wage base limits under IRC §§ 3121(a)(1) and 3306(b)(1), respectively. Instead, the wage base calculation had to be applied separately to each production company. As a result, the employees' wage bases were substantially increased, and E.P. paid additional FICA and FUTA taxes. E.P. sued for a refund, and the government countersued for penalties and interest.

E.P. and its co-plaintiffs pointed to section 3401(d)(1), which defines "employer" as the person for whom an employee performs services, except in cases where that person does not also have control of the payment of wages. In that case, the employer is the person who controls payment of wages. Since the plaintiffs, not the production companies, controlled payment of wages, the plaintiffs were the employers for purposes of determining the FICA and FUTA wage base, they argued. The IRS argued, and the court agreed, however, that the plaintiffs omitted a parenthetical but crucial phrase from the Code provision: "except for purposes of subsection (a)," which defines wages. Thus, for purposes of computing wages, including the FICA and FUTA wage base, section 3401(d)(1) doesn't apply, the court said. Instead, it held, the IRS was entitled to due deference toward its interpretation, for which the Service offered decades of supporting case law and administrative rulings and guidance uncontested by Congress. The court granted partial summary judgment to the government and denied it to the plaintiffs, and the parties entered discovery to determine the common-law employees. The discovery was continuing when the issue came before the same court in 2009 of the amount of SUI credit that the plaintiffs could use to offset their FUTA tax.

The SUI credit is allowed under section 3302. It is an amount equal to the sum of two tentative credits but it is capped at 5.4% of the taxpayer's total FUTA wage base. The two tentative credits are:

1. The amount the taxpayer paid into a qualified state unemployment fund (section 3302(a)); and
2. An amount equal to the difference between what the taxpayer actually paid into the fund and what it would have been required to pay into the fund under the state's highest rate (section 3302(b)).

In this instance, the plaintiffs' SUI credit was limited to 5.4% of their FUTA wage base. The IRS had used the plaintiffs' original FUTA wage base to compute their SUI credit. In its response to the plaintiffs' motion for summary judgment, the government conceded that the increased wage base was the proper basis for computing the SUI credit and that the IRS had erred in using the original wage base. The court granted

the plaintiffs' request for partial summary judgment and held they were entitled to an additional SUI credit in the amount of \$12,277,021 plus interest.

- ■ *Cencast Services LP et al. v. U.S.*, docket nos. 02-1916T through 02-1925T (Fed. Cl. 11/2/2009)

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