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Internal Revenue

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Internal Revenue – IRS Aggregate Estimates of Unreported Employee Tip Income to Determine Employer FICA Liability Now Constitutional – *United States v. Fior D'Italia, Inc.*, 122 S. Ct. 2117 (2002)

The Internal Revenue Service (“IRS”) is empowered to calculate and collect all unpaid federal taxes.¹ One such tax is the Federal Insurance Contribution Act (“FICA”) tax.² In the case of *United States v. Fior D'Italia, Inc.*³ the United States Supreme Court considered whether the IRS could make an aggregate estimate of restaurant worker unreported tip income for the purpose of collecting the employer’s portion of the FICA tax.⁴ The Supreme Court held the IRS’ aggregate estimation of unreported tip income was reasonable and therefore, constitutional.⁵ The IRS can now estimate unreported tip income and require an employer to pay FICA tax based on the estimate.⁶

The IRS determined that Fior D'Italia (“Fior”) underpaid their FICA taxes for the years 1991 and 1992.⁷ The IRS investigation concluded the restaurant employees had disclosed less tip income than was listed on Fior’s credit card receipts.⁸ Consequently, the IRS used an estimation technique to determine the actual amount of FICA tax that Fior owed for the years in question.⁹ The IRS, however, did not adjust the employee’s FICA tax liability to reflect the estimation.¹⁰ Fior challenged the legality of the method the IRS used to make the estimation in Federal District Court.¹¹

¹ See *United States v. Nat’l Bank of Commerce*, 472 U.S. 713, 720 (1985) (holding affirmative action allowable for IRS collection of unpaid taxes).

² See I.R.C. § 3111(a) (2002) (defining obligation of employer to pay FICA tax).

³ 122 S. Ct. 2117, 2121 (2002).

⁴ See *id.* at 2121.

⁵ See *id.* at 2127 (holding Fior’s argument insufficient to show IRS abuse of power). The relevant provisions of the I.R.C. grant authority to the IRS to use the aggregate method as long as the method is reasonable. *Id.* Fior still has the right to dispute the accuracy of the estimation. *Id.*

⁶ *Fior D'Italia Inc.*, 122 S. Ct. at 2121.

⁷ *Fior D'Italia v. United States*, 21 F. Supp. 2d 1097, 1098 (N.D. Cal. 1998), *aff’d*, 242 F.3d 844 (9th Cir. 2001), *rev’d*, 122 S.Ct. 2117 (2002). The IRS determined that Fior owed additional FICA taxes of \$11,976 for the year 1991 and \$11,286 for the year 1992. *Id.* Fior paid a portion of the tax under protest and initiated a suit for refund. *Id.*

⁸ *Fior D'Italia, Inc.*, 242 F.3d at 846, *rev’d*, 122 S. Ct. 2117. In 1991 the tips that were charged to a credit card totaled \$364,786 and the reported tips totaled \$274,181. *Id.* at 846 n.2. In 1992 the tips that were charged to a credit card totaled \$338,161 and the reported tips totaled \$220,845. *Id.* The IRS forces employees to disclose their tip income on Form 4070 if no other means are made available by the employer. I.R.C. § 6053(a) (2002); Treas. Reg § 31.6053-1(b)(2)(i) (2001).

⁹ See *Fior D'Italia, Inc.*, 21 F. Supp. 2d at 1098 (outlining IRS rationale for estimating).

¹⁰ *Fior D'Italia, Inc.*, 21 F. Supp. 2d at 1098.

¹¹ *Id.*

The method the IRS used to determine Fior's FICA tax liability for the years 1991 and 1992 reflected an understanding that every customer tipped and that all of the tip income was subject to FICA tax liability.¹² The IRS determined the average tip rate for each given year based on the reported tips.¹³ This average was then applied to Fior's gross receipts for each year in question.¹⁴ The method used by the IRS is considered an aggregate method and is sanctioned by the Internal Revenue Code ("I.R.C.") as long as the method is reasonable.¹⁵ The aggregate method is in stark contrast to the typical method used by the IRS for calculating an employer's FICA tax liability.¹⁶ An employer's FICA tax usually mirrors the individual employee's FICA tax on an employee-by-employee basis.¹⁷

The district court agreed with Fior holding that the IRS had exceeded its authority by using the aggregate estimation method for determining Fior's FICA tax liability and the Ninth Circuit Court of Appeals affirmed the decision.¹⁸ The district court held that Congress had expressed its intention that the employer's FICA tax liability should mirror that of the individual employee's.¹⁹ The reasoning of both lower courts was based on the proposition that the ultimate beneficiary of the FICA tax was the employee.²⁰ Therefore, it stood to reason that an employer would only be responsible for an equal contribution to the Social Security Insur-

¹² See *id.* (including all payments in total and dividing total by tip percentage).

¹³ See *Fior D'Italia, Inc.*, 242 F.3d at 846 (dividing total tips charged per year by total number of receipts). In 1991 the average tip rate was 14.49% and in 1992 the average tip rate was 14.29%. *Id.*

¹⁴ *Id.*

¹⁵ See I.R.C. §6201(a) (2002) (authorizing assessments on unpaid taxes). The IRS is allowed to use any method for the calculation of the unpaid taxes as long as it is reasonable. See, e.g., *Dodge v. Comm'r*, 981 F.2d 350, 353-54 (8th Cir. 1992) (holding bank deposits as method of estimation reasonable); *Erickson v. Comm'r*, 937 F.2d 1548, 1551 (10th Cir. 1991) (holding estimate of money paid derived from marijuana in possession reasonable); *Pollard v. Comm'r*, 786 F.2d 1063, 1066 (11th Cir. 1986) (holding donation totals as method of estimation reasonable); *Gerardo v. Comm'r*, 552 F.2d 549, 551-52 (3rd Cir. 1977) (holding assessment of illegal gambling revenue for estimation reasonable); *Mendelson v. Comm'r*, 305 F.2d 519, 521-22 (7th Cir. 1962) (holding gross receipts divided by average restaurant tip percentage reasonable method for determining unreported tips).

¹⁶ See *Fior D'Italia, Inc.*, 21 F. Supp. 2d at 1099 (instructing on usual means of determining employer FICA tax for tips). While the aggregate method calculates the employer's liability with regard to all of the employees, the typical method is to impose the liability on an employee-by-employee basis. *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 1104 (reasoning I.R.C. mandates employer FICA tax based on individual assessment of employee tips); *Fior D'Italia, Inc.*, 242 F.3d at 852 (holding Congressional authorization required for aggregate method).

¹⁹ See *Fior D'Italia, Inc.*, 21 F. Supp. 2d at 1101 (reasoning if Congress intended aggregate accounting they would have included it in I.R.C.).

²⁰ See *id.* at 1104 (emphasizing FICA tax not for revenue building). The district court reasoned that, because the beneficiary of social security benefits is the employee, the tax should be based on the individual employee's contribution. *Id.*

ance Fund that the employee paid.²¹ The lower courts based their decisions on an interpretation of the relevant provisions of the I.R.C. that demanded the employee and employer contributions mirror each other.²² The Supreme Court granted certiorari and reversed the Ninth Circuit, holding that the I.R.C. allowed for aggregate estimations and that mutuality was not required between the employer's contribution and the employee's contribution.²³

Tip income has always been subject to federal income tax, but, only recently has it been subject to FICA tax.²⁴ In 1965, Congress amended the I.R.C. to include tip income for the purpose of calculating the employee's FICA tax liability.²⁵ The employer, however, was not responsible for an equal contribution.²⁶ A 1977 amendment to the I.R.C. required employers to pay FICA tax on a portion of their employee's tip income.²⁷ The portion was equivalent to the employee's income up to the federal minimum wage amount.²⁸ Finally, in 1987 Congress amended the statute once again to require an employer to pay the same FICA tax that the employee is responsible for, regardless of whether the tip income exceeded the federal mini-

²¹ See *id.* at 1103 (claiming legislative intent was equal liability on employer and employee).

²² *Id.* at 1100. Section 3111 of the I.R.C., which imposes the employer portion of the FICA tax, refers to employees as individuals. I.R.C. § 3111 (2002). Further, § 3121(q), which imposes employer FICA liability on tip income, refers to individual employee's tip income. I.R.C. § 3121(q) (2002). The court held the language of these sections indicated the legislative intent for employee and employer FICA liability was to mirror each other. *Id.* at 1104.

²³ *Fior D'Italia, Inc.*, 122 S. Ct. at 2123. The Supreme Court found Fior's linguistic argument unpersuasive because there were other instances in the I.R.C. where the employee's wages were referred to in the plural. *Id.*

²⁴ See *Bubble Room, Inc. v. United States*, 36 Fed. Cl. 659, 672 (1996), *rev'd*, 159 F.3d 553 (1998) (citing history of FICA liability on tip income).

²⁵ See *id.* (noting shift in treatment of tip income regarding FICA tax). The IRS accounts for the employee's tip income when the statement documenting the income was given to the employer. I.R.C. § 6053(a) (2002). If the employee does not provide a statement, the IRS accounts for the income at the time of receipt. *Id.* The employer would then withhold the appropriate FICA tax. *Id.* The reason for the shift in policy was to allow tipped employees the benefit of the Social Security system. *Morrison Rests., Inc. v. United States*, 918 F. Supp. 1506, 1512 (S.D. Ala. 1996), *rev'd*, 118 F.3d 1526 (11th Cir. 1997).

²⁶ See *Bubble Room, Inc.*, 36 Fed. Cl. at 673 (citing Social Security Amendment of 1965, Pub.L. No. 89-97, Title III, § 313(c)(4), 79 Stat. 286, 383 (1965)); see also *Morrison Rests., Inc.*, 918 F. Supp. at 1512.

²⁷ See *Bubble Room, Inc.*, 36 Fed. Cl. at 673 (noting first time employer liable for FICA tax on tips); see also *Morrison Rests., Inc.*, 918 F. Supp. at 1512. The Social Security Amendments of 1977 were the statutes that changed the treatment of tips by the I.R.C. See *Bubble Room, Inc.*, 36 Fed. Cl. at 673.

²⁸ See *Bubble Room, Inc.*, 36 Fed. Cl. at 673 (explaining all tips above minimum wage not subject to employer FICA tax); see also *Morrison Rests., Inc.*, 918 F. Supp. at 1512 (outlining changes to I.R.C.).

num wage.²⁹ Consequently, the constitutionality of an aggregate method for calculating an employer's FICA tax liability was not relevant until 1987.³⁰

The relevant provisions of the I.R.C. that currently address employer and employee liability for FICA tax empower the IRS to collect the employer and employee taxes separately and does not require that they mirror each other.³¹ The employer's obligation to pay the FICA tax is listed in the I.R.C. in a completely different section than the obligations of the employee.³² Further, there is a longer statute of limitations allowed for the IRS to pursue the unpaid FICA tax of an employer than there is to pursue the employee.³³ This effectively allows the IRS to collect the FICA tax from the employer where no such tax has been collected from the employee or credited to the employee's social security account.³⁴ An aggregate method for determining FICA tax liability is not specifically listed in the I.R.C., but neither is it prohibited.³⁵ The assessment of an employer's

²⁹ See *Bubble Room, Inc.*, 36 Fed. Cl. at 673 (indicating first incident of symmetrical FICA obligation for tip income between employer and employee); see also *Morrison Rests., Inc.*, 918 F. Supp. at 1512 (explaining purpose of amendment to require both parties pay their share of FICA tax). The Omnibus Budget Reconciliation Act altered the I.R.C. to include § 3121(q), which requires equal FICA obligation with respect to tip income. See *id.* at 1512.

³⁰ See generally *Bubble Room, Inc.*, 36 Fed. Cl. at 673 (indicating no need for aggregate method until equal obligations); *Morrison Rests., Inc.*, 918 F. Supp. at 1512 (listing changes to I.R.C.).

³¹ See, e.g., I.R.C. § 3101 (2002) (imposing FICA tax on employee); I.R.C. § 3111 (2002) (imposing FICA tax on employer); I.R.C. § 3121(a) (2002) (calculating FICA tax as percentage of employee's wages); I.R.C. § 3121(q) (2002) (including tip income as wages). The separate sections of the I.R.C. indicate that Congress contemplated the employer FICA tax and the employee FICA tax separately. See *Morrison Rests., Inc.*, 118 F.3d at 1529 (explaining independence of each obligation); 330 West Hubbard Rest. Corp. v. United States, 37 F. Supp. 2d 1050, 1054 (N.D. Ill. 1998), *aff'd*, 203 F.3d 990 (7th Cir. 2000) (showing Congressional intent for independent obligation); see also *Bubble Room, Inc.*, 159 F.3d at 555 (holding statutory interpretation as important factor).

³² See *Morrison Rests., Inc.*, 118 F.3d at 1529; 330 West Hubbard Rest. Corp., 37 F. Supp. 2d at 1054; see also *Bubble Room, Inc.*, 159 F.3d at 555.

³³ See I.R.C. § 3121(q) (2002) (starting limitations period for collection of employer FICA obligation at IRS demand notice). The IRS demand could occur after the expiration of the time limitation for collecting the FICA tax from the employee. See *Fior D'Italia, Inc.*, 242 F.3d at 850.

³⁴ See I.R.C. § 3121(q) (2002) (indicating no limitation on IRS for timing of demand). The FICA tax obligation is not intended as a retirement fund for a specific employee. See *Bubble Room, Inc.*, 159 F.3d at 565. While the amount contributed will alter the amount received at retirement, the purpose of the Social Security Act has further reaching implications. See *id.* Money paid into the Social Security system is used to support retired and disabled people presently; therefore, FICA obligations of the employer are not earmarked for the employee specifically and may be collected independently of the employee's obligation. See *Fleming v. Nestor*, 363 U.S. 603, 609 (1960).

³⁵ See generally I.R.C. (2002) (determining no provision in I.R.C. addresses IRS authority to use aggregate method for employer FICA obligation). The I.R.C. does give the

FICA tax liability by the IRS may be rebutted with regard to its accuracy, however, the estimate does carry with it the presumption of correctness.³⁶

Opponents of the aggregate method for determining an employer's FICA tax liability claim that it is unreasonable for the IRS to use this method for several reasons.³⁷ First, the aggregate method does not take into account the fact that customers will generally tip at a lower percentage rate when paying by cash, or that most credit card companies charge a percentage of the bill for accepting the card.³⁸ Second, the method does not take into account the I.R.C. provisions that exempt FICA tax liability for tips that fall below twenty dollars in any given month or tip income that exceeds a certain amount for the whole year.³⁹ These two factors will consistently make the aggregate estimate higher than the actual amount.⁴⁰ Finally, these opponents argue that using the aggregate method of estimation will hold the employer responsible for taxes that it could not possibly know of in advance because they never possessed the tip income.⁴¹ The method will encourage the employer to change its business practices in order to accurately account for the tips to avoid underpaying their portion of the FICA tax.⁴²

IRS authority to "make the inquiries, determinations, and assessments of all taxes . . . which have not been duly paid." I.R.C. § 6201(a) (2002). The I.R.C. does authorize the IRS to make estimates of unpaid income tax where suitable records have not been kept. *See Mendelson v. Comm'r*, 305 F.2d 519, 521-22 (7th Cir. 1962) (allowing estimate of waitress' gross receipts where no records exist); I.R.C. § 446(b) (2002).

³⁶ *See, e.g., Palmer v. United States Internal Revenue Service*, 116 F.3d 1309, 1312 (9th Cir. 1997) (explaining presumption of correctness shifts burden of proof to tax payer); *United States v. Janis*, 428 U.S. 433, 440 (1976) (holding IRS assessments carry presumption of correctness in refund suit); *Psaty v. United States*, 442 F.2d 1154, 1160 (3rd Cir. 1971) (showing Congressional intent was for burden shift); *United States v. Lease*, 346 F.2d 696, 700 (2nd Cir. 1965) (showing further evidence of burden shift).

³⁷ *See supra* note 14 and accompanying text (showing reasonableness as bright line for estimate methods).

³⁸ *See Yukimura v. Comm'r*, 1982 WL 10891 (U.S. Tax Ct., 1982) (indicating credit card tips generally higher than cash tips); *see also Bubble Room, Inc.*, 36 Fed. Cl. at 677 (explaining 3% charge by credit card companies passed on to wait staff). Using the credit card receipts to determine the average tip received does not take into account the fact that credit cardholders usually have more money than non-credit cardholders and will generally tip at a higher rate. *See Yukimura*, 1982 WL 10891.

³⁹ *See* I.R.C. § 3121(a)(12)(B) (2002) (exempting FICA tax liability from tips amounting to less than \$20 per month); *see also* I.R.C. § 3121(a)(1) (2002) (exempting tip income from FICA liability exceeding amount fixed by Social Security Act). In 1991 the upper limit for FICA liability was \$55,400 and in 1992 it was \$55,500. *See Fior D'Italia, Inc.*, 242 F.3d at 846 n.4.

⁴⁰ *See supra* notes 37-38 and accompanying text (showing deficiencies in estimation method consistently raise assessments).

⁴¹ *See* 330 West Hubbard Rest. Corp. v. United States, 37 F. Supp. 2d 1050, 1054 (N.D. Ill. 1998), *aff'd*, 203 F.3d 990, 993 (7th Cir. 2000) (stating restaurants that pool tips will know total amounts).

⁴² *See Bubble Room, Inc.*, 36 Fed. Cl. at 678 (insisting employers should not have to

In *United States v. Fior D'Italia*, the Supreme Court articulated that an aggregate method of accounting for determining Fior's FICA tax liability with respect to its employee's undeclared tip income was reasonable.⁴³ The I.R.C. provides the basis for allowing the IRS to collect the tax from the employer without simultaneously collecting the tax from the employees.⁴⁴ The statute creates Fior's FICA tax obligation in a completely different section than the obligation of Fior's employees.⁴⁵ Further, it allows the IRS a longer statute of limitations to pursue Fior in an effort to collect the unpaid FICA taxes than it allows for the IRS to pursue Fior's employees.⁴⁶ The I.R.C. does not prohibit the IRS from using an aggregate method of accounting to calculate Fior's FICA tax liability, therefore, as long as the method is reasonable, the IRS may use it.⁴⁷

The Court held the aggregate method of accounting was reasonable because it merely created a legal presumption of correctness.⁴⁸ Fior was free to rebut the presumption.⁴⁹ However, Fior chose to dispute the authority of the IRS to use the aggregate method of accounting rather than to

police employee tip reporting).

⁴³ *Fior D'Italia v. United States*, 21 F. Supp. 2d 1097, 1098 (N.D. Cal. 1998), *aff'd*, 242 F.3d 844 (9th Cir. 2001), *rev'd*, 122 S.Ct. 2117, 2125 (2002); *see supra* note 14 and accompanying text (listing estimation methods that were held reasonable). Fior did not claim the estimate was inaccurate. *Id.* They merely claimed that the method of calculating the tax itself was patently inaccurate and therefore unreasonable. *Id.* The Supreme Court disagreed. *Id.*

⁴⁴ *See Fior D'Italia, Inc.*, 122 S. Ct. at 2123 (noting language in relevant I.R.C. sections not prohibitive of aggregate method). While the definitional portion of § 3121(q) does refer to the employer FICA obligation in terms of a single employee, the portion that creates the obligation speaks in the plural. *Id.*

⁴⁵ *See* I.R.C. § 3101 (2002) (imposing FICA tax on employee); I.R.C. § 3111 (2002) (imposing FICA tax on employer). The separate sections of the I.R.C. imposing the FICA obligations on the employer and the employee indicate that Congress intended for the taxes to be collected separately. *Bubble Room, Inc.*, 159 F.3d at 555; *Morrison Rests., Inc.*, 118 F.3d at 1529; 330 West Hubbard Rest. Corp. v. United States, 37 F. Supp. 2d 1050, 1054 (N.D. Ill. 1998), *aff'd*, 203 F.3d 990 (7th Cir. 2000).

⁴⁶ *See* I.R.C. § 3121(q) (2002) (imposing a penalty for non-payment of tax only after IRS makes demand). The interest does not even begin to accrue for late payments of the employer portion of the FICA tax for unreported tip income until the IRS makes demand. *See Fior D'Italia, Inc.*, 122 S. Ct. at 2125-26. It is at the time of the demand that the IRS considers the income paid to the employee. *Id.* at 2126. Therefore, even when the employee never pays his or her portion of the tax, the IRS can still collect from the employer. *Id.*

⁴⁷ *See supra* note 34 and accompanying text (indicating no statutory provision prohibiting an aggregate method of accounting); *see also supra* note 14 and accompanying text (allowing any reasonable method of accounting when no income records exist).

⁴⁸ *See Fior D'Italia, Inc.*, 122 S. Ct. at 2125 (explaining Fior's right to dispute accuracy of estimate). Fior did not persuade the Court with their argument that determining the amount of unreported tip income that was not subject to the FICA tax was impossible. *Id.* Proof of the inaccuracy was not required to be precise. *Id.* It need only prove that the estimate was inaccurate. *Id.*

⁴⁹ *See id.*

dispute the accuracy of the calculation.⁵⁰ If an argument had been made that the FICA liability was too high because certain wages were impermissibly included and that a lower percentage should have been used in the calculation, the Court may have adjusted the amount.⁵¹ Fior did not dispute the legal presumption of correctness, thus, the Court did not adjust the amount.⁵² The Court did uphold the authority of the IRS to use the aggregate method of accounting and ordered Fior to pay the FICA tax.⁵³

The Court's holding in *Fior D'Italia* creates a solution to the problem at bar.⁵⁴ It interpreted the I.R.C. correctly with regard to the authority of the IRS to use an aggregate method of accounting for undeclared tip income when determining the FICA liability of an employer.⁵⁵ The I.R.C. specifically creates an obligation for Fior to pay FICA tax as a percentage of all employee tip income.⁵⁶ The obligation is independent of the FICA tax liability incurred by Fior's employees.⁵⁷ The separate obligations are embodied by the different statutes of limitation applied with respect to collection of the FICA tax owed by Fior and its employees.⁵⁸ Further, the

⁵⁰ See *Fior D'Italia, Inc.*, 122 S. Ct. at 2125 (explaining basis of Fior's claim). Fior was required to pay the full amount of the demand because they stipulated the numbers used in the estimate were accurate and the method was held to be reasonable. *Id.*

⁵¹ See *id.* (suggesting alternative to Fior's claim).

⁵² *Fior D'Italia, Inc.*, 122 S. Ct. at 2127. The Court reversed the Ninth Circuit Court's decision. *Id.* at 2125. It suggested that if a separate claim had been made concerning the accuracy of the estimate, a remand would have been ordered to make the adjustment. *Id.*

⁵³ See *id.*

⁵⁴ See generally *Fior D'Italia, Inc.*, 122 S. Ct. 2117 (holding aggregate method allowable for employer FICA contribution).

⁵⁵ See *supra* note 34 and accompanying text (explaining basis of authority of IRS power to use aggregate method). The I.R.C. allows the IRS to investigate and assess all unpaid taxes. I.R.C. § 6201(a) (2002). Estimates are specifically authorized for income tax when records are absent or incomplete. I.R.C. § 446 (2002). Opponents of this decision claim that Congress knew how to give the IRS the power to estimate as shown in section 446; therefore, the omission of the language in the I.R.C. provisions pertaining to the FICA tax proves the power was not conferred. See *Fior D'Italia, Inc.*, 242 F.3d at 849.

⁵⁶ I.R.C. § 3121(q) (2002); see *supra* note 28 and accompanying text (indicating I.R.C. amendment creating employer FICA obligation for employee tip income).

⁵⁷ See *supra* notes 30-31 and accompanying text (imposing employer and employee FICA obligations separately).

⁵⁸ See *supra* note 32 and accompanying text (noting interest on unpaid employer FICA tax for unreported tip income runs from time of demand). The IRS may assess and demand the employer portion of the FICA tax for unreported tip income at any time. See 330 West Hubbard Rest. Corp. v. United States, 37 F. Supp. 2d 1050, 1054 (N.D. Ill. 1998), *aff'd*, 203 F.3d 990, 995 (7th Cir. 2000) (indicating no time limitation on IRS demand); Bubble Room, Inc. v. United States, 36 Fed. Cl. 659, 672 (1996), *rev'd*, 159 F.3d 553, 565 (1998) (showing employer FICA tax not due until IRS demand); Morrison Rests., Inc. v. United States, 918 F. Supp. 1506, 1512 (S.D. Ala. 1996), *rev'd*, 118 F.3d 1526, 1529 (11th Cir. 1997) (holding employee tip estimate allowed beyond employee statute of limitations). The interest will not begin to accrue until the IRS makes a demand because the tip income is considered paid to the employee at the time of the demand. 330 West Hubbard Rest.

aggregate method of accounting is reasonable because there is no other feasible way to assess and collect the FICA tax owed by Fior for the unreported tip income.⁵⁹

The Court did not depart from existing law in its decision to allow the aggregate method of accounting for unreported tip income.⁶⁰ The IRS has always used reasonable estimates to determine tax liability where official records of income are not available to them.⁶¹ There is no dispute as to the existence of Fior's FICA liability with regard to the unreported tip income, just the method of calculating the income.⁶² If the Court had prohibited the IRS from the use of the aggregate method of accounting to determine Fior's FICA liability, the only other means to collect the taxes would be to audit each and every employee individually.⁶³ Since the IRS does not have the capacity to conduct all of these audits within the statute of limitations prescribed by the I.R.C., a decision against the aggregate method would effectively eliminate the liability of both the employer and the employee.⁶⁴ Further, the estimate did not eliminate Fior's ability to respond to the tax.⁶⁵ Fior could have disputed the accuracy of the estimation if he felt the estimation was too high.⁶⁶

Corp., 203 F.3d at 995; *Bubble Room, Inc.*, 159 F.3d at 565; *Morrison Rests., Inc.*, 118 F.3d at 1529. The employee portion of the FICA tax will be unrecoverable if the statute of limitations runs. *330 West Hubbard Rest. Corp.*, 203 F.3d at 995; *Bubble Room, Inc.*, 159 F.3d at 565; *Morrison Rests., Inc.*, 118 F.3d at 1529. The IRS considers the employee paid when he or she receives the money. *330 West Hubbard Rest. Corp.*, 203 F.3d at 995; *Bubble Room, Inc.*, 159 F.3d at 565; *Morrison Rests., Inc.*, 118 F.3d at 1529. Consequently, the I.R.C. allows for employer payment without employee payment. *330 West Hubbard Rest. Corp.*, 203 F.3d at 995; *Bubble Room, Inc.*, 159 F.3d at 565; *Morrison Rest., Inc.*, 118 F.3d at 1529.

⁵⁹ *Fior D'Italia, Inc.*, 122 S. Ct. at 2126. Barring an aggregate estimation of tip income, the IRS would be forced to audit every employee separately. See *Bubble Room, Inc.*, 159 F.3d at 567. The IRS does not have the resources to do this. *Id.*

⁶⁰ See *Fior D'Italia, Inc.*, 122 S. Ct. at 2127 (stating I.R.C. and case law sanctions use of reasonable aggregate estimates).

⁶¹ See *supra* note 14 and accompanying text (showing examples of IRS estimations of income when records unavailable). The IRS has the authority to calculate and demand all unpaid federal taxes. I.R.C. § 6201(a) (2002). This authority necessarily carries with it the power to decide the method of calculation. See *Fior D'Italia, Inc.*, 122 S. Ct. at 2122.

⁶² *Fior D'Italia, Inc.*, 122 S. Ct. at 2124-25. Fior contends that aggregate estimations will always be inflated and are therefore unreasonable. See *id.* at 2125. Given the thin profit margins experienced by the restaurant industry, the mistake could jeopardize the business. See *id.* at 2124.

⁶³ See *Fior D'Italia, Inc.*, 242 F.3d at 850 (ordering employee audits to determine employer FICA liability). Individual audits of a restaurant's employees would require individual estimations because the records are still non-existent. See *Mendelson v. Comm'r*, 305 F.2d 519, 521-22 (7th Cir. 1962). There is no proof that this method would be any more accurate because these figures would also be estimates. *Fior D'Italia, Inc.*, 242 F.3d at 850.

⁶⁴ See *supra* note 32 and accompanying text.

⁶⁵ See *supra* note 35 and accompanying text (explaining IRS assessments as presump-

Future litigation is likely to result from the Court's decision in *Fior*.⁶⁷ Restaurants and any other businesses that utilize a tipping system will probably alter their practices to eliminate the possibility of tips being unreported.⁶⁸ They will either rid themselves of the gratuity system all together or they will create a scheme that pools the tips for accounting purposes before the income is distributed to the employees.⁶⁹ Congress has consistently opposed any statutory measure that attempts to force private business to alter its practices in an effort to improve record keeping.⁷⁰ The Court's decision may well be perceived as an attempt to alter the practices of private business.⁷¹ Ultimately, Congress may be forced to address the issue to insure that appropriate taxes are levied without infringing on the right of private industries to run their businesses in the best way they see fit.⁷²

In *United States v. Fior D'Italia, Inc.*, the Court considered the issue of whether the law allows the aggregate method of accounting when determining the employer's FICA tax liability with regard to unreported tip income.⁷³ It held the I.R.C. allows for the collection of an employer's portion of the FICA tax without collecting the employee's portion.⁷⁴ It further

tively correct). The burden of proof is on the taxpayer to show the assessment is inaccurate. See *Psaty*, 442 F.2d at 1160.

⁶⁶ *Psaty*, 442 F.2d at 1160.

⁶⁷ See *Fior D'Italia, Inc.*, 122 S. Ct. at 2130 (Souter, J. dissenting) (reasoning aggregate estimates anathema to I.R.C. exemption for employer records of tips). The I.R.C. specifically exempts employers from listing tip income on W-2 forms. I.R.C. § 6041(e) (2002). Allowing aggregate estimates of unreported tip income for employer FICA obligations will effectively minimize the benefit of the exemption and lead to future litigation. See *Fior D'Italia, Inc.*, 122 S. Ct. at 2130 (Souter, J. dissenting).

⁶⁸ See *Fior D'Italia, Inc.*, 242 F.3d at 848 n.6 (claiming business cannot be forced to change practices to avoid over paying taxes). Aggregate estimates of tip income are allowed; therefore, businesses will likely change their practices. See generally *Fior D'Italia, Inc.*, 122 S. Ct. 2117.

⁶⁹ See *Fior D'Italia, Inc.*, 242 F.3d at 848 (noting alternative measures to avoid owing taxes).

⁷⁰ *Fior D'Italia, Inc.*, 242 F.3d at 856 (McKeown, J., dissenting). The IRS had previously tried to coerce the employers into monitoring the employee's tip income. See *Fior D'Italia, Inc.*, 122 S. Ct. at 2126. Congress reacted to this pressure by enacting a law that gave a tax credit to the employer for all FICA taxes paid and a second that forbids the IRS from threatening an audit for not monitoring. See *id.*

⁷¹ See *Fior D'Italia, Inc.*, 122 S. Ct. at 2130 (Souter, J., dissenting) (commenting on majority opinion concerning business practices). The majority rejected the policy of making employers alter their business practices. *Id.* However, the only argument made by the IRS to refute the contention that business practices would change was that employers should hire trustworthy employees. *Id.* n.3.

⁷² See *Fior D'Italia, Inc.*, 242 F.3d at 852. Even though the Court allowed aggregate estimates to be used, Congressional acts or Treasury Regulations will be required to address the forced change in business practices. *Id.*

⁷³ *Fior D'Italia, Inc.*, 122 S. Ct. at 2121.

⁷⁴ See *supra* note 30 and accompanying text (showing I.R.C. contemplated separate

held that aggregate methods of accounting are allowed where records of income are incomplete or missing.⁷⁵ The practice is reasonable because the employer may rebut the accuracy of the estimate with proof that the amount of tips received is lower than the IRS is claiming.⁷⁶ The only problem with the Court's holding is that it may force the employer to change its business practices in order to obtain proof of the inaccurate estimates.⁷⁷

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payment of employer and employee FICA).

⁷⁵ See *supra* note 14 and accompanying text (listing several instances where estimates used in absence of accurate records).

⁷⁶ See *supra* note 35 and accompanying text (holding ability to rebut makes estimate reasonable).

⁷⁷ See *supra* note 67 and accompanying text.