

In the Supreme Court of the United States

GEORGE LAWRENCE FITZGERALD, PETITIONER

v.

KENNETH S. APFEL, COMMISSIONER
OF SOCIAL SECURITY

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

SETH P. WAXMAN
*Solicitor General
Counsel of Record*

DAVID W. OGDEN
*Acting Assistant Attorney
General*

JOHN HOYLE
CONSTANCE A. WYNN
*Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217*

QUESTION PRESENTED

Whether substantial evidence supports the decision of the Commissioner of Social Security to pierce the veil of petitioner's corporation and allocate undistributed corporate profits to petitioner as wages for purposes of determining whether petitioner received excess earnings that reduced the amount of his Social Security retirement benefits.

TABLE OF CONTENTS

| | Page |
|----------------------|------|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Statement | 2 |
| Argument | 4 |
| Conclusion | 7 |

TABLE OF AUTHORITIES

Cases:

| | |
|--|---------|
| <i>Gardner v. Hall</i> , 366 F.2d 132 (10th Cir. 1966) | 5, 6-7 |
| <i>Heer v. HHS</i> , 670 F.2d 653 (6th Cir. 1982) | 4, 5, 6 |
| <i>Johnson v. Chater</i> , 127 F.3d 756 (8th Cir. 1997) | 5, 6, 7 |
| <i>Martin v. Sullivan</i> , 894 F.2d 1520 (11th Cir. 1990) | 4, 5-6 |

Statute:

| | |
|---|---|
| Social Security Act, 42 U.S.C. 301 <i>et seq.</i> | 2 |
| 42 U.S.C. 403(b) | 2 |
| 42 U.S.C. 403(f) | 2 |

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No. 98-1595

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 12-16) is unpublished, but the decision is noted at 165 F.3d 910 (Table). The judgment and order of the district court (Pet. App. 17-19) affirming the memorandum and recommendation of the magistrate (Pet. App. 20-36) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 13, 1998. The petition for a writ of certiorari was filed on January 22, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

The Social Security Act, 42 U.S.C. 301 *et seq.*, limits the amount of income qualified applicants seeking retirement benefits may earn yearly, either through work for others or self-employment. 42 U.S.C. 403(b). Income in excess of the statutory limit is considered excess earnings and is deducted from the applicant's retirement benefit. 42 U.S.C. 403(f).

Petitioner, George L. Fitzgerald, is a licensed North Carolina attorney practicing as a solo practitioner. In May 1991, at age 65, he applied for retirement insurance benefits with the Social Security Administration (SSA). SSA found petitioner eligible for retirement benefits, but determined that excess earnings from his continued work offset the benefits due. In September 1991, petitioner incorporated his law practice, designating himself as president and treasurer and his legal assistant as secretary. In November 1991, petitioner notified SSA that his income from self-employment would be less than the \$8840 limit, and he requested retirement benefits beginning in January 1992. In February 1992, petitioner informed SSA that the corporation had been in operation since January 1992, that he was the only attorney employed by the corporation, and that he drew a salary of \$850 per month. Corporate tax returns indicated that the corporation grossed \$202,507 in 1992 and \$213,264 in 1993. Pet. App. 13.

In March 1992, SSA notified petitioner that he would not be paid Social Security retirement benefits because, for earnings-test purposes, he would be charged with his salary plus the ordinary income from his corporation. Pet. App. 51. In November 1992, after a hearing, an administrative law judge (ALJ) affirmed that deter-

mination, concluding that the corporation was the “alter ego” of petitioner and was established “for the sole purpose of avoiding the earnings test.” *Id.* at 80. The ALJ, noting that petitioner’s legal duties continued as before incorporation, ruled that petitioner’s true annual income equaled his salary plus the value of his services to the corporation—*i.e.*, the corporation’s net earnings. *Ibid.* SSA subsequently informed petitioner that excess earnings for 1992, 1993, and 1994 would prevent him from receiving retirement benefits for those years as well. *Id.* at 63. Petitioner also challenged those determinations. On December 13, 1995, the ALJ again denied petitioner’s claim for retirement benefits, citing petitioner’s excess earnings based on his salary and the corporation’s net income. *Id.* at 41-65. The Appeals Council denied review, and the ALJ’s decision became the final decision of the Commissioner of Social Security (Commissioner). *Id.* at 37-40.

Petitioner sought judicial review in federal district court, and both parties moved for summary judgment. Following the recommendation of the magistrate, the district court granted summary judgment in favor of the Commissioner. Pet. App. 18-19. Petitioner appealed, and the court of appeals affirmed in an unpublished, per curiam decision. *Id.* at 12-16. The court of appeals concluded that there was substantial evidence to support the Commissioner’s determination that petitioner was not entitled to retirement benefits. *Ibid.* The court of appeals reasoned that petitioner “had not retired from the practice of law nor had he relinquished any of the major managerial responsibilities of the corporation. * * * He worked the same number of hours, earning the same rate of income for himself and the corporation while drawing a disproportionately small salary that bore no relation to his

connection with the labor market. * * * He retained complete decision-making authority of the corporation as its president, treasurer, and sole shareholder.” *Id.* at 15-16. Accordingly the court concluded that because petitioner “continued to contribute substantial services to the corporation and ran the business as if it were a sole proprietorship,” the corporation “was not bona fide,” and the Commissioner’s decision “to pierce [the] fictitious salary arrangement and allocate the corporate earnings to [petitioner] personally was also supported by substantial evidence.” *Id.* at 16.

ARGUMENT

Contrary to petitioner’s contentions (Pet. 8-11), the court of appeals’ judgment upholding the Commissioner’s decision to pierce the corporate veil and to allocate undistributed corporate profits as personal earnings of petitioner is correct and does not conflict with any decision of another court of appeals. Accordingly, review by this Court is unwarranted.

1. The court of appeals correctly affirmed the Commissioner’s decision to pierce the veil of petitioner’s corporation. In applying the excess-earnings test, it is the responsibility of the Commissioner to determine whether an applicant’s earnings are “related to the reality of his connection with the labor market.” Pet. App. 15 (quoting *Martin v. Sullivan*, 894 F.2d 1520, 1524 (11th Cir. 1990)). The Commissioner also “has the authority to examine the substance of business transactions rather than [their] form and has the duty to pierce any fictitious arrangements designed to shift salary payments.” Pet. App. 15. See also *Heer v. HHS*, 670 F.2d 653, 655 (6th Cir. 1982).

As the court of appeals observed, petitioner “had not [really] retired from the practice of law nor had he

relinquished any of the major managerial responsibilities of the corporation.” Pet. App. 15. Petitioner worked the same number of hours and earned the “same rate of income for himself and the corporation while drawing a disproportionately small salary that bore no relation to his connection with the labor market.” *Ibid.* Indeed, petitioner admitted that he incorporated his law practice and set his salary at \$850 per month for the sole purpose of meeting the earnings test for receiving Social Security retirement benefits. *Id.* at 13-14. Because petitioner had not really retired and the corporation was not “bona fide” for Social Security purposes, the court of appeals correctly determined that it was appropriate for the Commissioner to disregard the corporate structure and allocate undistributed corporate earnings to petitioner personally. *Id.* at 16.

2. Contrary to petitioner’s claim (Pet. 8-10), the court of appeals’ decision is consistent with decisions of the Sixth, Eighth, Tenth, and Eleventh Circuits. See *Johnson v. Chater*, 127 F.3d 756 (8th Cir. 1997); *Martin v. Sullivan*, *supra*; *Heer v. HHS*, *supra*; *Gardner v. Hall*, 366 F.2d 132 (10th Cir. 1966). All of those courts agree that the Commissioner may look past particular pay arrangements and corporate formalities where the evidence shows that the individual seeking retirement benefits structured the pay arrangements to circumvent the excess-earnings test.

The Eleventh Circuit’s decision in *Martin* and the Sixth Circuit’s decision in *Heer* specifically affirm the Commissioner’s “right to examine the substance over the form” of all business pay arrangements. *Heer*, 670 F.2d at 655. In *Martin*, the Eleventh Circuit ruled that a wife’s increased corporate salary could be imputed to her retired husband where the evidence showed that,

despite the salary shifting, the husband continued his pre-retirement work activities and the wife's duties remained unchanged. 894 F.2d at 1530. Because "the Secretary must be assured that the alleged retirement is legitimate, actual and bona fide," *id.* at 1532, the Eleventh Circuit sustained the Commissioner's disregard of the formal salary allocation.

In *Heer*, the plaintiff and his wife were the sole shareholders of a family corporation. 670 F.2d at 654. When the plaintiff allegedly "retired," there was an increase in his wife's salary with no attendant increase in her duties. *Ibid.* The Sixth Circuit, agreeing with SSA that the pay arrangement was fictitious, held that it was appropriate to reallocate part of the wife's income to the plaintiff. *Id.* at 655-656.

Although both *Martin* and *Heer* involved the shifting of payment between family members, the principle underlying the decisions is not so constrained. See *Martin*, 894 F.2d at 1532; *Heer*, 670 F.2d at 655. If the integrity of the Social Security retirement program is to be maintained, the Commissioner must be able to determine whether an applicant has really retired, and whether the salary paid for the applicant's services is in line with the labor market, as distinguished from a salary that is set merely to avoid the excess-earnings test. Pet. App. 15. Accordingly, neither *Martin* nor *Heer* conflicts with this case.

The Tenth Circuit's decision in *Gardner* and the Eighth Circuit's decision in *Johnson* likewise do not conflict with the decision below. In each case, the court recognized that the corporate veil or salary arrangement may be pierced in appropriate circumstances, *Johnson*, 127 F.3d at 759; *Gardner*, 336 F.2d at 135, and simply concluded that SSA had erred in doing so on the facts of the particular case. In *Gardner*, the Tenth

Circuit ruled that the Commissioner erred in allocating undistributed corporate profits to petitioner as wages because the corporation was a bona fide corporate entity. 366 F.2d at 135. The court explained that the “corporate entity must be respected” where evidence is lacking that the corporation is “a sham or a pretense.” *Id.* at 135-136. Similarly, in *Johnson*, the Eighth Circuit reversed the Commissioner’s allocation of undistributed corporate profits where there was no evidence that the corporation was a sham. 127 F.3d at 762.

The decisions in *Gardner* and *Johnson* rested on the ground that the corporation at issue was bona fide. In contrast, there is substantial evidence in this case to support the Commissioner’s determination that petitioner’s corporation was not bona fide (Pet. App. 16); indeed, petitioner presents no argument to the contrary. There accordingly is no conflict between the decision below and either *Gardner* or *Johnson*.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General

DAVID W. OGDEN
*Acting Assistant Attorney
General*

JOHN HOYLE
CONSTANCE A. WYNN
Attorneys

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