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railroad" do not constitute taxable compensation (Wisconsin Central Ltd, v. U.S. ...

Ken Berry • Jun. 25, 2018



In a new case harkening back to the days of F.D.R., the U.S. Supreme Court decided by a narrow 5-4 vote that stock options paid to employees who were “working on the railroad” do not constitute taxable compensation (Wisconsin Central Ltd, v. U.S., S Ct. No. 17-530, 6/21/18).

The roots of the new Supreme Court ruling trace back to the Railroad Retirement Tax Act of 1937. This legislation was designed to protect employees from the threat of railroads going under in the wake of the Great Depression. Under the Act, Congress authorized pensions for railroads employees that were funded by a tax tied to compensation. These pensions were generally more generous than the Social

Security benefits available to employees in other industries. For these purposes,

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compensation under the Act. The U.S. government disagreed. After the lower courts rejected this argument, a divided panel for the Seventh Circuit Court affirmed, resulting in the case being heard by the top court in the land.

The outcome? The Supreme Court has reversed and ruled that stock options provided to the employees are not money remuneration and, therefore, are exempt from tax.

For starters, the Supreme Court reviewed the meaning of money remuneration and established that stock options aren't money in the same vein as a medium of exchange. In contrast to say, cash, stock options aren't accepted in exchange for goods or services rendered. In reaching this conclusion, the Court referred to the differing treatment of "money" and "stock" within the Internal Revenue Code and the Federal Insurance Contributions Act (FICA). Because the FICA definition omits the modifier "money" from the description of "remuneration," the Court reasoned that this distinction was intentional.

In addressing the government's arguments, the Court rejected the viewpoint that stock options could be treated as money remuneration because they can be converted into money. It stated that taking this approach would essentially render the term "money compensation" meaningless. The Court also dismissed the argument that the Act's express omission of "qualified" stock options from taxation implies that nonqualified stock options, such as the ones presented in this case, are subject to tax.

Finally, the Court referenced regulations relating to in-kind benefits under the Act that contemplated that such benefits would be taxable only if the employer and employees agreed to treat them as money remuneration.

Justice Neil Gorsuch wrote the majority opinion. "Our case arises from a peculiar feature of the statute and its history. At the time of the Act's adoption, railroads compensated employees not just with money but also with food, lodging, railroad

tickets, and the like,” he said. “Because railroads typically didn’t count these in-kind

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