

## POTENTIAL REFUND CLAIM FOR FICA TAXES ON SEVERANCE PAYMENTS MADE IN A REDUCTION IN FORCE

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On September 7<sup>th</sup>, 2012, the 6<sup>th</sup>Circuit upheld the District Court's decision in *U.S. v. Quality Stores*, holding that severance payments made to employees in connection with an involuntary reduction in force were not "wages" subject to FICA taxes. *United States v. Quality Stores, Inc. (In re Quality Stores, Inc.)*, 424 B.R. 237 (W.D. Mich. 2010), aff'd, 10-1563, 2012 U.S. App. LEXIS 18820 (6<sup>th</sup>Cir. September 7, 2012). In so holding, the 6<sup>th</sup>Circuit reasoned that such severance payments were supplemental unemployment compensation benefits ("SUB Pay") within the meaning of § 3402(o)(2) of the Internal Revenue Code (the "Code") exempt from FICA taxes.

This holding is directly at odds with the position of the Internal Revenue Service ("IRS"), set forth in Revenue Ruling 90-72, that such severance payments are wages for FICA purposes and not SUB Pay. According to the IRS, the definition of SUB Pay in § 3402(o)(2) of the Code is not applicable for FICA purposes. The IRS has defined SUB Pay for FICA purposes through a series of revenue rulings. Under the IRS definition, SUB Pay must be linked to the receipt of state unemployment compensation and must not be received in a lump sum in order to be excludable from wages for FICA purposes. The 6<sup>th</sup>Circuit rejected the IRS definition reasoning that Congress intended the same definition to apply for both FICA and income tax withholding purposes and that, to the extent that Congress has permitted the IRS to decouple the definition, it must be done by regulation and not by administrative rulings.

The IRS may issue a nonacquiescence and petition the U.S. Supreme Court for certiorari. The petition may be granted because this decision has created a split in the courts. In *CSX Corp. v U.S.*, 518 F.3d 1328 (Fed. Cir. 2008), the Federal Circuit Court of Appeals held that the severance payments at issue were subject to FICA taxes.

Employers may be entitled to a FICA tax refund for FICA taxes paid on severance payments made pursuant to an involuntary reduction in force, the discontinuance of a plant or operation or other similar condition. As a result, employers who made severance payments in any open year under these circumstances may want to assert a protective claim by filing Form 941-X prior to the applicable statute of limitations deadline. A protective claim must be filed by April 15, 2013 for

payments made in 2009. In the meantime, employers should continue to treat such payments as subject to FICA taxes pending further developments.

## MEET THE TEAM



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