

## TAX ALERT

### SIXTH CIRCUIT NIXES FICA TAX ON SEVERANCE PAY

by: John B. Burns  
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The U.S. Court of Appeals for the Sixth Circuit has affirmed a Michigan Bankruptcy Court and approved a taxpayer's request for a refund of FICA taxes paid on behalf of former employees. *Quality Stores et al.*

As part of a company-wide reduction in force, Quality Stores made severance payments to terminated employees and collected and remitted the FICA tax to the IRS. After determining that FICA taxes were improperly withheld and remitted, Quality Stores sought over \$1 million in tax refunds for itself and over 1,800 former employees. Quality Stores asserted that the severance payments were not wages for FICA purposes. Rather, it asserted that the severance payments were Supplemental Unemployment Compensation Benefits ("SUBs") and that such payments were not taxable under FICA.

The IRS rejected Quality Stores' refund request and contended that in order to be exempt from FICA taxes, the SUBs must have been conditioned upon the employees' receipt of other unemployment benefits and that the SUBs must have been paid in installments, rather than in a lump sum as was the case with the Quality Stores SUBs.

The Court specifically rejected the IRS' argument, finding it to be an imposition of additional limitations which were not warranted by prevailing law, regulations and legislative history. The Court found that the SUB payments were made to assure workers of unemployment security and were a reward for tenure with the company, not deferred compensation for services rendered. Consequently, the Court determined that the SUB payments were not "wages" for purposes of FICA, though the payments were "wages" for federal income tax withholding.

While the Sixth Circuit's opinion applies principally to employers in Michigan, Ohio, Tennessee, and Kentucky, the decision should prompt all employers contemplating a reduction in force to consider the applicability of FICA taxes to any benefits paid and to structure the severance payments so as to minimize the applicability of FICA taxes. Moreover, those employers who have paid FICA taxes on such payments should consider filing refund claims on behalf of themselves and former employees.

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