



BURNING BENEFITS NEWS

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OPPORTUNITY TO FILE POTENTIAL FICA REFUND CLAIMS ON SEVERANCE PAY

The conflict over the FICA tax treatment of severance payments has resurfaced. A recent decision of the U.S. District Court for the Western District of Michigan surprisingly held that certain involuntary separation payments were not subject to FICA taxes (*U.S. v. Quality Stores, Inc.*). This decision restores the potential for FICA refunds for companies that have made severance payments pursuant to layoffs, bankruptcies or site closings since 2006.

The court found that severance payments made by Quality Stores to its employees pursuant to both pre-petition and post-petition bankruptcy periods severance programs were not wages for FICA purposes because the payments fell within the Internal Revenue Code Section 3402(o)(2) exception to wages for supplemental unemployment compensation benefits. Quality Stores filed for bankruptcy in October, 2001. The payments met the definition of supplemental unemployment compensation benefits since they were made because of the employees' involuntary separation from employment directly due to a reduction in force or discontinuance of a plant or operation. The payments were not connected to the receipt of state unemployment compensation and were not attributable to the rendering of employment services. Payments pre-petition were paid weekly or semi-weekly and post-petition payments were paid in a lump sum.

The severance payments were included in the employees' gross income and FICA was withheld from the employees' and the employer paid its portion. In 2002, Quality Stores filed refund claims with the IRS for the overpaid FICA.

Bankruptcy court concluded that the severance payments were not wages for FICA purposes, relying in part on the 2002 CSX Federal Court of Claims decision (*CSX Corp. v. U.S.*, (52 Fed. Cl. 2008 (Fed. CL. 2002))) holding that severance payments made to employees under pre-petition and post-petition severance programs were not wages for FICA purposes. However, in 2008, the Court of Appeals for the Federal Circuit reversed the 2002 decision and held that severance pay due to various downsizing programs was subject to FICA (*CSX Corp. v. U.S.* (518 F.3d 1328 (Fed. Cir. 2008))). Given the CSX reversal, the government moved for reconsideration in the bankruptcy court of its earlier Quality Stores decision. The bankruptcy court reaffirmed its prior decision. In light of the CSX Federal Court 2008 decision, the IRS is likely to appeal this pro-taxpayer Quality Stores decision.

CONSIDER ACTION BY APRIL 15, 2010: Employers, particularly those residing within the jurisdiction of the Sixth Circuit (i.e., Kentucky, Ohio, Michigan, and Tennessee) who made significant involuntary severance payments to employees, may want to consider filing protective FICA tax refund claims for 2006, which is the oldest calendar year for which the statute of limitations is set to expire on April 15, 2010. A decision to file FICA tax refund claims for later years may be deferred for the time being. The deadline for filing FICA tax refund claims for 2006 severance payments is April 15, 2010.

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