

April 6, 2010

MEMORANDUM TO CLIENTS

RE: Déjà Vu– Another Court Rules That Severance Pay is Not FICA wages

For over two years, everyone thought that the question regarding whether severance payments were subject to FICA taxes was finally answered. In 2008, the Court of Appeals for the Federal Circuit reversed the lower court's decision in CSX Corp v. United States, 52 Fed. Cl. 208 (2002), holding that severance payments were wages for FICA taxes and not SUBs (supplemental unemployment compensation benefits) because the payments were not contingent on receipt of state unemployment benefits as required by Revenue Ruling 90-72.

Now another court – the district court for the western district of Michigan – has held that severance payments are SUBs, without regard to state unemployment benefits and Revenue Ruling 90-72, and therefore exempt from FICA taxes.

Specifically, in United States v. Quality Stores, Inc., a debtor in bankruptcy closed a number of retail stores and through its severance plans paid periodic and lump sum payments to employees due to their involuntary separation from employment that resulted directly from a reduction in force or the 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 any particular employment service. The severance payments were treated as wages for employment tax purposes, and thereafter the employer claimed a refund for the FICA taxes paid.

The analysis largely tracks the lower court's decision in CSX -- (1) the payments are SUBs under Code section 3402(o)(2) and, therefore, exempt from wages for both income tax and FICA purposes, and (2) the "anti-Rowan " language -- nothing in the regulations prescribed for purposes of chapter 24 (which includes 3402(o)) which provides for an exclusion from "wages" as used in such chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter (FICA taxes) -- does not govern because Revenue Ruling 90-72 is not in the form of an IRS regulation.

Action Steps

The IRS has the stronger position to treat severance payments as FICA wages, and at this point employers should continue to withhold applicable FICA taxes. However, to preserve a future refund claim, an employer can file protective claims based on the court's decision. The process for filing a protective claim is rather routine (e.g., [Form 941-X for the applicable period](#)) and does not need to be filed until just prior to the running of the statute of limitations. To the extent that any of the payments are covered by the 6th Circuit (Kentucky, Ohio, Michigan, and Tennessee, where this case may be appealed), a protective claim would be even more prudent. Therefore, employers who paid severance payments in 2006 should file protective claims by the **April 15, 2010 deadline**, but continue to subject such payments to FICA taxes.

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If you have any questions, or need assistance filing a protective claim, please contact your regular Groom contact or any of the attorneys listed below:

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