Reinhart

Severance Benefits May Not Be Subject to FICA Taxes: You May Need to File a Protective Refund Claim Soon

In *United States v. Quality Stores*, 693 F.3d 605 (6th Cir. 2012), the Court of Appeals for the Sixth Circuit held that certain severance amounts paid to employees upon involuntary termination of employment in connection with a reduction in workforce or plant closing were not subject to Federal Insurance Contributions Act (FICA) taxes. This Sixth Circuit decision creates a conflict among the circuits as it directly conflicts with a decision of the Court of Appeals for the Federal Circuit. As a result, many employers should consider filing protective refund claims with the Internal Revenue Service (IRS) for the FICA taxes on certain types of severance payments. The statute of limitations on requesting a refund of FICA taxes on severance payments made in 2009 will run out on April 15, 2013.

The United States is expected to file a petition for certiorari with the Supreme Court. If granted, the Supreme Court may ultimately determine whether certain severance payments are subject to FICA taxes, which could result in a significant refund of FICA taxes to businesses and individuals.

Background

The Internal Revenue Code imposes FICA taxes (*i.e.*, Social Security and Medicare Tax) on both employers and employees to fund the Social Security and Medicare programs. FICA taxes are due on all "wages" paid to an employee, with "wages" defined as "all remuneration for employment." The IRS has long taken the position that severance payments constitute "wages" and are subject to FICA taxes. However, the IRS has recognized a narrow exception for severance payments made under a supplemental unemployment benefit (SUB) plan, but in order to qualify for this exception, the payments must be linked to the receipt of state unemployment compensation. See Rev. Rul. 56 249, 1956 1 C.B. 488 as modified by Rev. Rul. 90 72, 1990 2 C.B. 211. In 2008, the Court of Appeals for the Federal Circuit affirmed the IRS's position and held that severance payments paid to employees in connection with an employer's reduction in workforce were subject to FICA taxes because the benefits were not paid under a plan that met the IRS definition of a SUB plan. *CSX Corp. v. U.S.*, 518 F.3d 1328 (Fed. Cir. 2008).

POSTED:

Jan 17, 2013

RELATED PRACTICES:

Real Estate
https://www.reinhartlaw.com/practices/real-estate

Tax
https://www.reinhartlaw.com/practices/tax

RELATED PEOPLE:

Don M. Millis
https://www.reinhartlaw.com/people/don-millis

Kristina E. Somers
https://www.reinhartlaw.com/people/kristina-somers

Margaret M. Derus
https://www.reinhartlaw.com/people/margaret-derus

All materials copyright © 2025 Reinhart Boerner Van Deuren S.C. All rights reserved.

Quality Stores involved severance payments made by a retailer that filed bankruptcy. The retailer closed its stores and distribution centers and terminated its employees. Many of the terminated employees received severance payments that were not linked to the receipt of state unemployment compensation. The Sixth Circuit Court of Appeals held that such severance payments qualified as SUB payments and thus did not constitute wages subject to FICA taxes. The court stated that to qualify as a SUB payment, the payment must be: (1) paid to an employee; (2) pursuant to an employer's plan; (3) because of an employee's involuntary separation from employment, whether temporary or permanent; (4) resulting directly from a reduction in work force, the discontinuance of a plant or operation, or other similar conditions; and (5) included in the employee's gross income. The SUB payments need not be tied to an employee's receipt of state unemployment compensation benefits. Thus, the court expressly declined to follow past IRS rulings and the decision in *CSX Corp*.

Steps You Should Take to Preserve Refund Claims

With the recent downturn in the economy, many businesses turned to employee lay-offs, which resulted in substantial severance payments. In light of the decision in *Quality Stores*, businesses and individuals should consider taking the necessary steps to protect their rights.

Employers should file a protective refund claim (a specific procedure exists for doing this, which is beyond the scope of this e-alert) for FICA payments that fall under *Quality Stores*. The general statute of limitations on filing a refund claim for quarterly employment tax returns is three years starting from April 15 of the succeeding year. As such, businesses must file a protective refund claim relating to calendar year 2009 by April 15, 2013. The IRS will likely hold the refund claims in abeyance until the litigation is ultimately resolved, but these claims protect the employer and, if the litigation is ultimately resolved in a taxpayer favorable manner, such employer (and applicable employees) could receive a significant FICA refund.

Steps You Should Take If You Are Considering a Reduction in Work Force or a Plant Closing

If you are considering a future reduction in work force or a plant closing, it may be advisable to create a severance plan that meets the requirements described in *Quality Stores*. In addition, employers can create SUB plans that meet current IRS

All materials copyright © 2025 Reinhart Boerner Van Deuren S.C. All rights reserved.

requirements and benefit from the FICA exclusion regardless of the ultimate outcome of the *Quality Stores* case. IRS-approved SUB plans, however, are subject to detailed written and administrative requirements, but in certain cases it may be worth the cost of operating the SUB plan in such a manner.

We will continue to follow the progress of the *Quality Care* decision and other cases and rulings on this issue. If you have any questions or desire assistance with filing a protective refund claim in a manner that preserves the FICA refund for both the business and individuals, please contact your attorney, Michael G. Goller,Lucien A. Beaudry or any member of Reinhart's Tax, Employee Benefits or Labor and Employment teams.

These materials provide general information which does not constitute legal or tax advice and should not be relied upon as such. Particular facts or future developments in the law may affect the topic(s) addressed within these materials. Always consult with a lawyer about your particular circumstances before acting on any information presented in these materials because it may not be applicable to you or your situation. Providing these materials to you does not create an attorney/client relationship. You should not provide confidential information to us until Reinhart agrees to represent you.

All materials copyright © 2025 Reinhart Boerner Van Deuren S.C. All rights reserved.