

# PUBLICATION

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## Severance Payments: To Tax or Not to Tax, that is the Question!

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On October 1, 2013, the U.S. Supreme Court agreed to hear the federal government's appeal of the Sixth Circuit Court of Appeals' decision in *United States v. Quality Stores, Inc. (In re Quality Stores, Inc.)*, 693 F.3d 605 (6th Cir. 2012). The Internal Revenue Service (IRS) filed its petition for certiorari with the U.S. Supreme Court on May 31, 2013, asking the Court to consider whether severance payments made to employees who are involuntarily terminated are subject to Social Security and Medicare taxes under the Federal Insurance Contributions Act (FICA).

In *Quality Stores, Inc.*, the Sixth Circuit Court of Appeals upheld a bankruptcy court's ruling that these severance payments were not wages, and, therefore, not subject to FICA taxes. Quality Stores issued severance payments to employees affected by a layoff, and withheld applicable FICA taxes from those payments. The company subsequently filed for a tax refund on the basis that the severance plan payments were supplemental unemployment benefits, and therefore not wages for FICA purposes. The district and appellate courts held that the severance payments were, in fact, not remuneration for services under FICA, and therefore the refund to Quality Stores was proper.

The IRS, however, disagreeing with the district and appellate courts, filed its 26-page petition for certiorari. In its petition, the IRS reiterated its longstanding position that severance payments are subject to employment taxes, based on the broad definition of "wages." The IRS also emphasized the need for a final determination on the proper tax treatment of these payments. The Supreme Court granted the request, and will consider this issue during the upcoming term.

In addition to resolving a split among the circuits on this issue, a decision by the Supreme Court affirming the *Quality Stores* decision could also result in billions of dollars of FICA returns for employers that have made severance payments withholding FICA taxes. Until that time, however, employers with involuntary employee terminations during the years currently open under the applicable statute of limitations (2010 through present) might consider filing protective FICA tax refund claims, prior to any potential legislation or action on behalf of the IRS in response to the *Quality Stores* decision.

We will continue to monitor this case and provide an update when the Supreme Court issues its decision.