

FICA Taxes Withheld From Severance Payments in Connection with Reductions-in-Force: Are You Entitled to a Refund?

Are you an employer who withheld FICA taxes in connection with severance payments made as part of a reduction-in-force? If so, based on a recent decision from the Sixth Circuit Court of Appeals, your company may be entitled to a refund of amounts paid to the IRS.

The Federal Insurance Contributions Act (FICA) tax is a payroll tax imposed on both employees and employers. Most wages and salary are subject to FICA tax. Both employers and employees are obligated to pay FICA tax. Employers typically withhold the FICA taxes owed by their employees.

A highly watched case decided in late 2012 by the Sixth Circuit, *United States v. Quality Stores, Inc.*, addressed whether certain severance payments are subject to FICA withholding. In *Quality Stores*, the Sixth Circuit ruled that severance payments to employees pursuant to an involuntary reduction-in-force are not wages for purposes of FICA tax. The Sixth Circuit reasoned that the severance payments qualified as “supplemental unemployment compensation benefits.” As such, the payments are exempt from the definition of “wages” for purposes of FICA taxation. The practical outcome of the Sixth Circuit’s ruling is that the employers and employees who withheld FICA taxes are entitled to a refund from the Internal Revenue Service.

The reach of the Sixth Circuit’s decision is unclear. Under *Quality Stores*, employers located in states within the Sixth Circuit who paid FICA taxes to the IRS on severance payments made to employees pursuant to an involuntary reduction-in-force, planned closure, or similar

circumstances are entitled to refunds. Those states are Kentucky, Michigan, Ohio and Tennessee.

The Sixth Circuit's decision leaves unclear whether isolated severance payments that are not part of a reduction-in-force are considered wages for purposes of FICA tax withholding. Based on the government's position in *Quality Stores* that the severance payments should have been considered wages, the government is likely to interpret *Quality Stores* narrowly and continue to reject claims for refunds where the case arguably does not apply. The government is also likely to reject claims made by employers located outside the Sixth Circuit. Furthermore, the Sixth Circuit's decision conflicts with a decision from the Federal Circuit Court of Appeals, and the government will almost certainly petition the Supreme Court to review the case.

This issue thus remains far from clear. Nevertheless, it may behoove employers, particularly those who made severance payments in connection with sizable reductions-in-force, to file claims for refunds of the FICA taxes they paid. Employers should consult with their tax advisor or tax counsel in connection with doing so.