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E-ALERT | Tax & Employee Benefits

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SIXTH CIRCUIT HOLDS SEVERANCE PAY FOR LAYOFFS NOT SUBJECT TO FICA TAXES

Today the United States Court of Appeals for the Sixth Circuit sided with taxpayers in affirming the decision of a district court that certain severance payments that qualify as supplemental unemployment compensation benefit payments (or "SUB" payments) for federal income tax purposes are not subject to tax under the Federal Insurance Contribution Act (FICA). *United States v. Quality Stores, Inc.*, No. 10-1563 (6th Cir. Sept. 7, 2012).

Covington & Burling LLP submitted an *amicus* brief on behalf of the ERISA Industry Committee in support of the taxpayers' position maintaining that SUB payments should not be treated as wages subject to FICA taxes, because, among other reasons, SUB payments are not treated as wages for federal income tax purposes. The government maintained that the term "wages" has different definitions for FICA and income tax purposes and that all severance payments are wages subject to FICA taxes if they (1) are paid in lump sum or (2) are not conditioned on the receipt of state unemployment benefits. The Federal Circuit had agreed with the government in *CSX Corp. v. United States*, 518 F.3d 1328 (2008), *rev'g* 52 Fed. Cl. 208 (2002).

In affirming the district court, the Sixth Circuit rejected the government's position and the contrary holding of the Federal Circuit. Under the Sixth Circuit's decision, a payment qualifies as a SUB payment if it is

- an amount paid to an employee;
- pursuant to an employer's plan;
- because of an employee's involuntary separation from employment, whether temporary or permanent;
- resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions; and
- included in the employee's gross income.

In adopting this definition, which is based on the definition of SUB payments for federal income tax purposes found in the Internal Revenue Code, the Circuit Court gave no deference to a revenue ruling by the Internal Revenue Service that had rejected this definition. According to the court, the revenue ruling did not "take[] congressional intent fully into account."

In deciding that the term "wages" has the same meaning for income and FICA tax purposes, the Sixth Circuit relied on *Rowan Cos. v. United States*, 452 U.S. 247 (1981). The government argued that the present validity of *Rowan* had been weakened by Congressional action and subsequent Supreme Court decisions, such as *Mayo Found. for Med. Educ. & Research v. United States*, 131 S. Ct. 704 (2011). The Sixth Circuit rejected the government's arguments finding that *Rowan* remains good law.

We expect the government will formulate a position concerning the *Quality Stores* decision in the next several weeks. Given the split in the circuits, the government might choose to seek *certiorari* in the Supreme Court. We will continue to monitor and report on the government's position .

In light of the *Quality Stores* decision, employers might want to consider filing refund claims for FICA taxes paid on past severance payments that qualify as SUB payments. Employers that already have filed such refund claims may need to obtain extensions of the period for filing a lawsuit pending a decision on the government's position. We would be pleased to assist employers in pursuing refunds with respect to SUB payments. In addition, we can assist employers in reviewing the structure of their existing severance plans to minimize liability for FICA taxes in the future.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our firm:

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