

## Recent Court Decision Rules That Severance Pay For Laid-Off Employees Is Exempt From FICA Tax

By Steven R. Gerlach & Karen S. Aframe | March 11, 2010

In a startling new decision, *United States v. Quality Stores, Inc.*, a district court in Michigan ruled that severance payments made to employees pursuant to an involuntary reduction in force are not subject to Social Security taxes. This case involved a bankrupt retailer that closed all its stores and let its employees go. In ruling that severance pay is exempt from FICA taxes, the court noted that the tax code requires employers to treat severance paid to laid off workers as if it were wages for withholding purposes, indicating that severance pay is not “wages” for FICA tax purposes. The court also rejected the IRS’ position that severance avoids FICA tax only if it is tied to receipt of unemployment benefits.

Although the IRS will almost certainly appeal this decision, employers should consider filing refund claims for FICA tax paid on severance pay as a protective measure, citing this new decision. IRS will hold on to the protective claims until after the appeal is decided. This is particularly critical for business that had layoffs in 2006, because the statute of limitations for 2006 expires April 15th, a little over a month away.

In filing protective claims, employees can file for their half of the FICA tax or employers can claim both halves. In claiming both, employers must first refund the employees’ share or get their consent to file for their portion. In the latter situation, the employer agrees to refund the employee’s share of FICA directly to them if the refund claim proves successful. To get help with filing protective claims, please contact Steve Gerlach at our Portland, Maine, office at (207) 774-1200, or Karen Aframe at our Manchester, New Hampshire, office at (603) 623-8700.