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SUPREME COURT REQUIRES FICA WITHHOLDING FOR CERTAIN SEVERANCE PAYMENTS IN QUALITY STORES RULING

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On March 25, 2014, the Supreme Court of the United States ruled unanimously (8-0) that certain supplemental unemployment benefit payments (“SUB payments”) received by employees who were involuntarily terminated when their employer entered Chapter 11 bankruptcy were taxable “wages” for purposes of Social Security and Medicare taxation under the Federal Insurance Contribution Act (“FICA”). [The Court’s opinion](#), drafted by Justice Kennedy, reversed the judgment of the Sixth Circuit in *In re Quality Stores, Inc.*, 693 F.3d 605 (6th Cir. 2012), resolving a circuit split between the Sixth Circuit and a few other Circuits. This case is noteworthy because many employers had filed protective refund claims based on earlier judicial decisions.

In reaching its conclusion, the Court focused on the plain text of the FICA definition of wages: “all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash.” It was comfortable that the SUB payments at issue were made “for employment” because they were made in consideration for “any service of whatever nature, performed . . . by an employee for the person employing him.”

The construction and history of the statute that defines “wages” under FICA reinforced the Court’s determination that the SUB payments were wages. First, the FICA “wages” definition exempts severance payments made because of retirement or disability, an exemption that the Court noted would not be necessary if severance payments were generally exempt from FICA’s definition of wages. Second, although the general FICA definition of wages has been substantively the same since it was enacted in 1935, the addition of a 1939 exception for “dismissal payments which the employer is not legally required to make” was later repealed, demonstrating congressional intent that such payments are wages.

The Court’s decision does not disrupt current Internal Revenue Service (the “IRS”) guidance that exempts SUB payments tied to the receipt of state unemployment benefits from both federal income tax withholding and FICA taxation. Certain statements made during the oral arguments before the Court, however, imply that the IRS might consider changing its position on such administrative guidance. Additionally, although the Court’s holding addressed only the SUB payments specifically at issue, the Court’s opinion often discusses “severance payments” broadly, and it is unclear the extent to which its holding might be applied to other types of severance payments.

Please contact a member of Dilworth Paxson’s Tax Department or Employee Benefits Group if you would like to discuss any aspect of this ruling or its effect on your business planning.