

Supreme Court Rules that Severance Payments Are Taxable Under FICA

March 27, 2014 | Blog |

VIEWPOINT TOPICS

- Employment

RELATED PRACTICES

RELATED INDUSTRIES

Written by Erin C. Horton

I have to admit, when I read the news that the Supreme Court had ruled earlier this week that severance payments are “wages” subject to payroll taxes, I thought I was on crazy pills: Didn’t we already know that? But, apparently, the IRS had received a ton of refund claims specifically related to FICA taxes paid on severance, to the tune of more than \$1 billion. So, while some of us thought that this ship had sailed, others seemed to be holding onto hope.

On Tuesday, the nation’s highest court unanimously held that bankrupt agricultural retailer Quality Stores, Inc. and about 1,850 of its former employees were not entitled to approximately \$1 million in FICA tax refunds. Collection of FICA taxes helps fund the Social Security and Medicare programs. Overturning the Sixth Circuit Court of Appeals’ decision, the Supreme Court rejected Quality Stores’ argument that severance payments are not “wages” as defined under FICA, because they are not paid for services rendered. Instead, the Court reasoned that severance benefits are “remuneration for employment,” because an employee’s service to his or her employer is more than just work performed, but broadly encapsulates the entire employer-employee relationship. The Court noted, in particular, that insofar as severance benefits are paid exclusively to employees, are calculated on the basis of job function and seniority, and are designed to attract the best talent, they are compensation for an employee’s service.

For most employers, this means business as usual: Keep paying payroll taxes on any severance payments you make and don’t expect to see that money ever again. For those employers who had hoped for a break, no such luck.

Authors