

Attorneys React: US vs. Quality Stores

Law360, New York (March 25, 2014, 9:44 PM ET) -- The U.S. Supreme Court ruled Tuesday, in *US. v. Quality Stores Inc.*, that certain severance payments made to employees terminated against their will are taxable wages under federal law. Here, attorneys react to the ruling:

David P. Doyle, Day Pitney LLP

"The significance of today's Quality Stores ruling is that it finally puts to bed the question of whether severance payments are, and were, subject to FICA withholding and taxation.

"The Supreme Court ruled that severance payments are in fact subject to FICA, reversing the Sixth Circuit's ruling. The Sixth Circuit's ruling was based upon statutory construction, while the Supreme Court focused on historical treatment of severance pay.

"The Supreme Court's ruling effectively puts an end to the hopes of the many corporate taxpayers that had filed protective claims for refund with respect to FICA paid in connection with severance payments over the past several years."

Adam S. Fayne, Arnstein & Lehr LLP

"The ruling brings clarity to a gray area that impacts not only typical employment matters, but also litigation settlement matters. When parties are settling wage claims and other employment litigation matters, whether or not severance allocations will be taxable is very relevant to the negotiation because it can mean more or less money in the plaintiff's pocket."

David Fuller, Morgan Lewis & Bockius LLP

"After the court's decision, the SUB-Pay exclusion still exists, but employers must now carefully consult with their advisers to draft, adopt and implement SUB-Pay arrangements that take into account the different rules and regulations of each state's unemployment system."

Bob Hertzberg, Pepper Hamilton LLP, representing Quality Stores

"Today, the Supreme Court made clear that severance payments for employees terminated against their will generally are subject to taxation under the Federal Insurance Contributions Act.

"This decision is a huge blow for employers and employees alike, and, in addition to the impact on Quality Stores and its former employees, this ruling has far-reaching implications for the thousands of other organizations and workers fighting for refunds.

"Basing its decision primarily on the 'broad definition of wages under FICA,' the court ruled against the taxpayer. In its ruling, the court noted that IRS revenue rulings provide that severance payments tied to

the receipt of state unemployment benefits 'are exempt not only from income tax withholding but also from FICA taxation,' citing IRS Revenue Ruling 90-72 issued in 1990. The court specifically declined to reach the question of whether 'the IRS' current exemption is consistent with the broad definition of wages under FICA.'

"While, of course, we are very disappointed in the court's decision, we knew that such an outcome was a possibility. We will continue to study the decision and its implications."

Alan M. Levine, Morrison Cohen LLP

"Today's Supreme Court ruling in Quality Stores is a win for the IRS, but also one that does not settle the issue of whether all severance is subject to FICA taxation. In siding with the IRS, the court held that severance other than where paid pursuant to a 'supplemental unemployment benefits' plan (where payments are tied to state unemployment benefits) is subject to FICA taxation. However, still unresolved is whether severance that is paid under a 'SUB' plan is exempt from FICA taxation. The IRS has previously held that it is not, but may now desire to reconsider the issue."

Virginia E. McGarrity, Robinson & Cole LLP

"The decision is a welcome relief for the IRS, as it will prevent substantial FICA tax refunds. As highlighted in its petition for certiorari with the court, the previous uncertainty of the proper tax treatment of these payments has resulted in 11 substantially similar cases pending and more than 2,400 protective refund claims, with a total amount at stake of more than \$1 billion."

Vicki M. Nielsen, Ogletree Deakins Nash Smoak & Stewart PC

"Although not unexpected, the Supreme Court's holding that severance paid to involuntarily discharged employees is subject to FICA will be disappointing to the many employers that filed FICA-tax refunds following workforce reductions in response to changes in the economy over the last several years to their discharged employees, who either participated in those refund claims or filed their own, and to future financially-strapped employers and discharged employees. On the other hand, the government will not be faced with paying out the over \$1 billion dollars of FICA tax refunds relating to this issue. In addition, employers in all industries across the United States that implemented a SUB plan that links severance pay to the receipt of state unemployment benefits, in accordance with the IRS's administrative rulings issued over the last half-century, are going to be relieved that the Supreme Court's decision left the IRS's rulings intact. Pursuant to the IRS's current ruling position, severance paid pursuant to a SUB plan to involuntarily discharged employees that is linked to the receipt of unemployment benefits and that is not paid in a lump sum is FICA exempt."

Bennett Pine, Anderson Kill PC

"The significance of the Quality Stores opinion may lie in the doors it closes. Had the court allowed for the nontaxability of severance payments for involuntarily terminated employees, that would have invited the parties' representatives to find increasingly creative ways to structure severance payments that would not be taxable. Until a few years ago, plaintiff's attorneys often sought to avoid taxation of an employment settlement by classifying the payment as 'compensation for personal and emotional injuries.' The IRS closed that loophole by requiring physical manifestation of injuries. Justice Kennedy has seemingly eliminated another avenue for tax avoidance on this front."

James F. Podheiser, Stradley Ronon Stevens & Young LLP

"The immediate significance of today's decision is two-fold. First, it relieves the Treasury of having to issue billions of dollars of refunds to employers across the country that have pending claims for refund of FICA taxes paid on severance. Second, it relieves Congress of the burden of amending the FICA tax

rules to achieve the result which the court's decision achieves, which in my opinion is something Congress surely would have done had the court gone the other way. As word of the court's decision spreads, it is most likely that those employers who in the past had been ill-advised or very risk tolerant and had not treated severance as subject to FICA tax will fall in line and follow the decision."

Veenita Raj, Michelman & Robinson LLP

"While this ruling doesn't really change the landscape (from the status quo) in terms of tax consequence on traditional severance pay itself, it makes one thing for certain however—it will force employers to consider providing supplemental unemployment benefits over traditional severance pay in mass layoff/reduction in force cases, while choosing traditional severance pay where a release of claims is desired. The former will not only provide a significant tax saving to the employer and the employee, it also allows the employer to reduce impact on its cash flow by providing for periodic payments versus lump sum."

Matthew Richardson, Sheppard Mullin Richter & Hampton LLP

"On Tuesday, March 25, 2014, the U.S. Supreme Court ruled in favor of the Internal Revenue Service in a dispute over the payroll tax treatment of certain types of severance compensation. The justices, in an 8-0 vote, overturned the Sixth Circuit's opinion in Quality Stores Inc., which held that severance pay made in connection with an involuntary separation from employment due to a reduction in force, plant shutdown or similar condition (so-called supplemental unemployment compensation benefits) is not subject to tax under the Federal Insurance Contribution Act (FICA). The stakes in the case were huge because, if Quality Stores Inc. had won, thousands of additional tax refund claims would likely have resulted, with a total cost to the government of as much as \$1 billion."

Phillip Schreiber, Holland & Knight LLP

"The court's ruling means that neither employers nor involuntarily separated employees will be able to avoid the payment of FICA and other taxes on severance payments. This may result in employers paying less severance to involuntarily separated employees because of the tax burden. Conversely, former employees may demand more severance to make up for the tax burden. To reduce their tax burden but still offer enticing severance benefits to separated employees, employers may increase the noncash component of their severance benefits, such as offering outplacement services."

William Weissman, Littler Mendelson LLP

"The court's 8-0 Quality Stores decision reaffirming that severance is taxable as wages is not surprising, and is consistent with the court's other recent decisions upholding the IRS's interpretation of tax law. The court noted that the IRS still allows severance payments tied to receipt of state unemployment benefits to be exempt from both income tax withholding and FICA if certain requirements are met, such as funding a trust and paying amounts tied to receipt of unemployment benefits. For a variety of business reasons, most employers' severance plans simply do not to meet these requirements."

Victoria Zerjav, Kelley Drye & Warren LLP

"The decision of the Supreme Court in Quality Stores today could result in employers who believed that FICA withholding was not required on severance payments facing significant penalties and interest relating to under-withholding and late payment of employment taxes for severance payments made to involuntarily terminated employees, going back multiple years. Many employers have never treated those severance payments as anything other than wages, so ultimately it would have very little impact on them other than to remove a potential issue from their list now that the Supreme Court has rendered a decision."

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