

Employers May Be Eligible for Refund of Severance Pay FICA Taxes

PUBLISHED ON

February 1, 2013

Employers who have made severance payments to laid off employees may be entitled to refunds of Federal Insurance Contributions Act ("FICA") taxes remitted in connection with such payments. According to a ruling from the United States Court of Appeals for the Sixth Circuit, finalized just last month, severance payments qualifying as supplemental unemployment compensation benefit ("SUB") payments are not taxable as wages, and accordingly, are not subject to FICA taxes. The Internal Revenue Code defines SUB payments as (1) payments made to an employee, (2) pursuant to an employer's plan, (3) because of an employee's involuntary separation from employment, whether temporary or permanent, (4) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, and (5) included in the employee's gross income.

If your company's severance payments satisfy this definition, consult your tax advisor promptly to explore preserving potential refund claims. A company can file a protective tax refund claim for any taxable year that remains open. Typically, a taxable year remains open until three years after the date the return was due or two years after the payment date, whichever is later. As a result, an employer's 2009 income tax return (assuming such employer reports on a calendar year) will typically remain open until April 14, 2013.

To obtain refunds of SUB payments, employers must secure each terminated employee's written consent to file the refund claim for FICA taxes withheld on the employee's behalf. Additionally, employers must pay employees their share of any refunded FICA taxes.

For employers with operations within the Sixth Circuit's geographic area (Michigan, Ohio, Kentucky, and Tennessee), their refund claims for SUB payments may be processed now. All others, including employers operating in Pennsylvania, will have to wait and see how the issues resolve. The Government has until April 4, 2013 to appeal the issue to the United States Supreme Court, and Congress could amend the Internal Revenue Code to clarify the definition of SUB payments. But if the Sixth Circuit's decision is not overturned or amended, it could be extended throughout the country.

Despite the uncertainty, this is an area with potentially significant financial implications for employers who have been forced to lay off employees over the last several years. Such employers should decide soon whether to file refund claims to avoid missing out on the potential financial benefit if the Sixth Circuit's decision stands or is extended to other areas of the country.