



## U.S. Supreme Court Holds that Severance Pay is Generally Subject to FICA, but SUB Payments Remain Exempt for the Time Being

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Earlier this week, the U.S. Supreme Court held unanimously in favor of the IRS, ruling in *United States v. Quality Stores, Inc.* that severance payments are generally subject to Federal Insurance Contributions Act (FICA) taxes, which are comprised of Social Security and Medicare taxes.

In 2001 and 2002, Quality Stores terminated employees in connection with its bankruptcy filing and offered them severance packages which varied based on their positions with the company and years of service. Quality Stores paid FICA tax on these amounts, then later asked the bankruptcy court to order the IRS to refund the FICA payments.

At issue before the Court was not whether the payments were subject to income tax—that was already clearly true—but whether they were wages for FICA purposes. The Court began its analysis by turning to the statute, which includes as FICA wages “all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash.” The statute goes on to provide that “employment” encompasses “any service, of whatever nature, performed ... by an employee for the person employing him.” Accordingly, the Court concluded that severance payments are “remuneration for employment.” Further, the payments made by Quality Stores were based on individuals’ positions with the company and their years of service—in other words, they were tied to the individuals’ *employment*.

Previously, the Sixth Circuit had held that the unemployment payments at issue were not subject to FICA. The Supreme Court disagreed with the Sixth Circuit’s analysis. Although the parties had previously stipulated that Quality Stores’ payments were SUB payments, the Court found that the payments were not tied in any way to the receipt of state unemployment benefits and, thus, the exemption for SUB payments did not apply.

While declining, based on the facts of *Quality Stores*, to extend its holding to all SUB payments, the Court alluded to the inconsistency in this position—why should SUB payments be exempt from FICA taxation when other severance payments are not? How are the Revenue Rulings exempting severance payments tied to the receipt of state unemployment benefits from FICA consistent with the plain meaning of the FICA statute?

Many employers have filed for a FICA tax refund in recent years, pending the Supreme Court’s final decision. With the issuance of the *Quality Stores* opinion, the IRS has prevailed on these claims. We will be watching to see

whether the IRS will revise its prior Revenue Rulings in a manner that maximizes its ability to collect FICA tax on SUB plans too.

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