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# Got Severance? Supreme Court May Have To Decide This One

For purposes of income-tax withholding and Social Security (FICA), wages generally include all remuneration for employment. But what if your employer pays you severance when you leave? Severance pay is common, but is it for performing services?

Arguably no. Severance pay is gap pay to cover some period of time **after** the employee finishes rendering services. This distinction may not seem important, but significant tax dollars can turn on it. The law is strangely muddled.

Severance can be paid for a variety of reasons. Severance may be company policy, required by state or federal law, or paid pursuant to an agreement between the company and the former employee. It could be paid after a lawsuit.

Of course, severance pay is fully taxable for income tax purposes, and it is subject to income tax withholding. The question is whether it is **also** subject to payroll taxes like Social Security tax. You might assume so, and that's certainly what the IRS thinks.



But it turns out the courts have reached differing decisions. In 2002, the Court of Federal Claims considered severance pay made in downsizing programs implemented by CSX. The court ruled it was **not** wages under the Social Security (FICA) tax. See [CSX Corp. v. U.S., 52 Fed. Cl. 208 \(Apr. 1, 2002\)](#). However, in 2008, the Court of Appeals for the Federal Circuit reversed and held that the severance pay **was** subject to FICA after all. See [CSX Corp. v. U.S., 518 F.3d 1328 \(Mar. 6, 2008\)](#).

Still, that's not the last word. In 2012, the Court of Appeals for the Sixth Circuit reached the opposite result. Quality Stores was in a Chapter 11 bankruptcy and made severance payments to terminated employees. In [U.S. v. Quality Stores](#), the Sixth Circuit said severance pay was **not** wages.

Quality Stores had treated the payments as wages, withholding federal income and employment taxes and paying the IRS. Later, the company filed for a refund. The Bankruptcy Court concluded that the severance payments were not wages for FICA purposes. The district court affirmed and then the Sixth Circuit affirmed too.

So is severance pay wages or not? It depends on who you believe. The IRS thinks the Federal Circuit was correct in *CSX Corp.* Taxpayers, on the other hand, are generally more persuaded by the Sixth Circuit's ruling in *Quality Stores*.

The IRS has asked the Supreme Court to review the Sixth Circuit's ruling. In the meantime, the IRS has suspended action on administrative refund claims totaling \$127 million from approximately 800 taxpayers within the Sixth Circuit. The Sixth Circuit includes Kentucky, Michigan, Ohio, and Tennessee.

More troubling, the IRS has been disallowing refund claims filed by employers **outside** the Sixth Circuit. The IRS hopes the Supreme Court will take the *Quality Stores* case and reverse it, making *CSX Corp.* the law of the land. It is too soon to say how this split will turn out. If you are impacted by this and the dollars are significant, get some advice to protect your rights.

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