

PUBLICATION

FICA Update: Sixth Circuit's Quality Stores Decision

September 25, 2012

On September 7, 2012, the Sixth Circuit Court of Appeals affirmed a lower court decision granting a significant refund to Quality Stores, Inc. for taxes paid under the Federal Income Contributions Act (FICA). At issue in *United States v. Quality Stores, Inc.* was whether supplemental unemployment compensation benefits (SUB payments) paid to employees pursuant to an involuntary reduction in force were taxable as "wages" under FICA.

In *Quality Stores*, the taxpayer made periodic and lump-sum SUB payments to employees whose employment was involuntarily terminated in connection with the closing of several hundred company facilities. The taxpayer withheld and remitted federal income tax and the employer's share of FICA taxes on the SUB payments, but later filed a timely request for refund for the FICA portion. The basis of the taxpayer's refund claim was that the SUB payments did not constitute "wages" for FICA purposes.

Congress defined "wages" for FICA purposes in Section 3121(a) of the Internal Revenue Code of 1986, as amended (Code). Section 3121(a) provides that "wages" means (with numerous exceptions) "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash..." An almost identical definition was adopted in Code Section 3401(a) for federal income tax withholding purposes. The income tax withholding provisions, however, provide additional guidance in Section 3402(o) entitled: "Extension of Withholding to Certain Payments Other Than Wages" (underscore provided). Included in this "other than wages" category are SUB payments, which are defined in Code Section 3402(o) essentially as:

1. an amount paid 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 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.

Citing both the statute, applicable regulations and the legislative history, the Sixth Circuit concluded that SUB payments meeting the above-mentioned description are not "wages" for income tax purposes. The Sixth Circuit then extended this conclusion to the FICA context relying on the Supreme Court's 1981 decision in *Rowan Cos. v. United States*.

In *Rowan*, the Supreme Court examined the plain language and legislative history of Code Sections 3121(a) and 3401(a) to conclude that Congress intended the term "wages" to carry the same meaning for purposes of FICA and federal income tax withholding. Because SUB payments are not considered "wages" (although nevertheless taxable) for federal income tax purposes, and also because the definition of "wages" carries the same meaning for both purposes, the Sixth Circuit ruled that SUB payments were not subject to tax under FICA.

In deciding *Quality Stores*, the Sixth Circuit created a conflict with an earlier federal circuit-court decision from 2008, *CSX Corp. v. United States*. It is currently unknown whether the federal government will appeal the *Quality Stores* decision to the Supreme Court.

The *Quality Stores* decision represents a significant opportunity for employers to obtain a refund for FICA taxes on SUB payments in the Sixth Circuit (Tennessee, Michigan, Ohio and Kentucky) and potentially in other Circuits. If you have any questions about this decision, or would like to discuss whether your organization may file a FICA tax refund claim, please contact one of the attorneys in the Firm's Tax Department.