

U.S. Supreme Court's Severance Ruling Impacts Future Unemployment Benefits

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The decision in *Quality Stores* not only kills FICA tax refunds for millions of unemployed workers, but it also requires proactive employer actions to maximize future employer and state unemployment benefit payments to terminated workers.

The U.S. Supreme Court's decision in *United States v. Quality Stores, Inc.*^[1] is the most significant payroll tax opinion issued in the last 30 years, if not ever. Not only does it put an end to the thousands of Social Security and Medicare (FICA) tax refund claims filed by employers on their own behalf and on behalf of millions of terminated workers, but it also may impact and limit the extent to which future downsized workers are eligible to receive state unemployment benefits.

In *Quality Stores*, the Supreme Court ruled that termination payments to involuntarily terminated employees that are not tied to state unemployment benefits are taxable "wages." The Court rejected the taxpayer's argument that downsizing payments are not taxable wages if the payments satisfy the statutory definition for "supplemental unemployment compensation benefits," or SUB-Pay, enacted by Congress for federal income tax withholding purposes.

Impact on Past Years

The vast majority of FICA tax refund claims asserting exempt SUB-Pay status will not withstand scrutiny after *Quality Stores*. However, a small number of refund claims do satisfy the Internal Revenue Service (IRS) administrative test left intact by the Court and should be "perfected" or finalized by those employers. Before letting the limitations period on any of the SUB-Pay refund claims expire, employers should consult with their tax advisers on whether they should (1) perfect claims that satisfy the IRS definition of SUB-Pay; (2) continue to file protective refund claims, Forms 907, or Forms 2297; or (3) simply let the statute of limitations expire. Most employers will likely choose the latter option, which the IRS says employers should implement by simply taking no action and letting the underlying statute of limitations expire in coming months and years.

Impact on Future Years

Although little can now be done to recoup the FICA taxes paid on the downsizing payments issued to millions of downsized workers, employers should turn their focus to efforts to limit the adverse impact

the Court's decision may have on the ability of future downsized workers to simultaneously receive state unemployment benefits and employer-funded downsizing payments. State unemployment regulators have been tracking this case for its impact on state unemployment benefits.

SUB-Pay was developed in the 1950s because it was important that employer payments to terminated workers not be construed as wages—otherwise, the recipients would be disqualified from receiving state unemployment benefits in most states. Although the unemployment systems have changed over the last half-century to modify the various wage prohibitions (generally by loosening the original restrictions), most states still will not pay unemployment benefits if a worker continues to receive any “wages” from a former employer. The broad definition of “wages” results in the denial of most of the existing FICA tax refund claims while, at the same time, limiting the eligibility of some future downsized workers to qualify for state unemployment benefits. This places employers in the difficult position of potentially discontinuing downsizing benefits or risking their terminated employees becoming ineligible for state unemployment benefits.

Conclusion

Although little can be done about the adverse impact of the Court's decision on prior years' FICA tax refund claims, employers that undertake future downsizings because of acquisitions, restructurings, or economic conditions still have one or two narrow paths to ensure that their employees can receive both state unemployment benefits and downsizing benefits, including seeking to maximize the employer and employee tax aspects of such arrangements.

[1]. No. 12-1408 (Mar. 25, 2014), available [here](#).

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