Government files petition for certiorari in Quality Stores

June 5, 2013

In brief

On May 31, the final day of its extension period, the government filed a petition for certiorari with the US Supreme Court in *United States v. Quality Stores, Inc*. If granted, the Supreme Court will decide whether severance payments made to employees as a result of an involuntary reduction in force are 'wages' for FICA tax purposes. The Sixth Circuit held that supplemental unemployment compensation benefits (SUB pay) made to former employees were not wages subject to FICA taxes. However, the Sixth Circuit's ruling is in direct conflict with the Federal Circuit Court of Appeals' opinion in *CSX Corp. v. United States*, where the court held that similar payments were subject to FICA taxes.

In its petition, the IRS estimates that the total dollar amount at stake as a result of the *Quality Stores* decision is over $1 billion. Given the circuit split, the amount at issue and the desirability of a uniform rule, many commentators believe the case is a good candidate for Supreme Court review. As a result, it is imperative that employers take the necessary steps to preserve their rights to FICA tax refunds for severance payments made during 2010 and subsequent years.

In detail

What's next?

Quality Stores must reply to the petition by July 1, 2013. However, due to the Court's summer recess, its decision to grant or deny review will not likely be announced until late September or October. If the Supreme Court grants review and concurs with the Sixth Circuit, employers should be able to obtain refunds for FICA taxes paid on severance payments made to employees on account of involuntary workforce reductions. If the Supreme Court declines to hear the case, the IRS may grant refunds to employers whose principal places of business are located in the Sixth Circuit (that is, Kentucky, Michigan, Ohio, and Tennessee) and continue to contest refund claims elsewhere. However, continued litigation would likely impede the IRS's ability to enforce the tax laws on a uniform basis. Thus, the government may consider other alternatives such as issuing additional regulations to address the matter on a prospective basis and entering into a global settlement program with taxpayers who have filed protective refund claims. In any event, the government's decision to seek Supreme Court review could signal the beginning of the end to a controversy that has persisted for over a decade. Consequently, employers should consider taking proactive steps to address these refund opportunities as soon as possible.

Employer action required

All employers that have paid severance in connection with involuntary workforce reductions should consider filing refund claims as soon as possible for all tax years open under the statute of limitations (i.e., calendar years subsequent to 2009). In the past, taxpayers

have been advised to delay filing protective claims until near the statute's closing date due to the prolonged nature of the litigation and the administrative tasks required once the protective claims are filed. For example, in order to maintain their protective claims for refund, employers must file Form 907, *Agreement to Extend the Time to Bring Suit*, within two years of receiving a notice of claim denial. By delaying the filing of its protective refund claims, there was less risk that taxpayers would have to file more than one Form 907. However, given the IRS's decision to seek Supreme Court review, new legislation or published guidance or a global settlement program may be imminent if the Supreme Court denies review. Thus, employers should consider filing refund claims as soon as possible for all open years in order to ensure that their claims are included in a settlement program or are filed before any new legislation is introduced in Congress.

The process for filing protective refund claims is relatively straightforward. A protective claim must contain key information such as the essential nature of the claim and the contingencies affecting the claim. It does not have to state a particular dollar amount. As a result, protective claims require a much smaller investment of time and resources than actual claims.

In addition, employers that have previously filed protective refund claims should begin the planning process for 'perfecting' any previously filed protective claims. This would entail gathering the appropriate employee-level data in order to support the amount of the refunds, sending correspondence to affected employees, and determining whether the severance pay satisfies the statutory definition of SUB pay. If the IRS ultimately issues refunds to claimants, the Service may provide notice directly to all employers that previously filed claims, issue guidance in the form of a revenue procedure or expect employers to follow traditional refund claim procedures. In any case, employers should have a plan in place so that they are prepared to move forward with the claim perfection process in a timely manner.

The takeaway

Employers that made severance payments in connection with involuntary reductions in force in 2010 and all subsequent years should consider filing protective tax refund claims as soon as possible. In addition, employers should continue to monitor the two year period for filing suit, continue to withhold on future SUB payments, and consider perfecting any claims previously filed.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

US Tax Controversy and Dispute Resolution:

Kathy Mort, *Pittsburgh*
+1 (412) 355.6064
kathy.mort@us.pwc.com

Christine Flohr, *Washington, DC*
+1 (202) 346.5294
christine.l.flohr@us.pwc.com

Megan Marlin, *Washington, DC*
+1 (202) 346.5144
megan.e.marlin@us.pwc.com