
Preserve Your Right to a Payroll Tax Refund

Gray Reed & McGraw Legal Alert

January 28, 2014

By Jason Luter

A disagreement between two federal appeals courts regarding whether payroll taxes must be paid on severance payments made to laid-off workers has landed the issue in front of the U.S. Supreme Court. Oral arguments began January 14th, 2014. How the Supreme Court decides the case, called *United States v. Quality Stores, Inc.*, may result in payroll tax refunds being owed to both employers and employees who paid or received severance over the past few years.

Payroll taxes, which are comprised of Social Security tax of 6.2% up to a wage cap (\$113,700 in 2013) plus Medicare tax of 1.45% (without a wage cap), are owed on all wages, and are paid by both employers and employees. In the *Quality Stores* case, however, the Supreme Court will address a disagreement between federal appeals courts regarding whether certain severance payments are, in fact, “wages.” Severance payments have historically been treated as wages subject to payroll taxes, but the Sixth Circuit Court of Appeals recently came to the opposite conclusion. If the Supreme Court agrees with the Sixth Circuit, then the result could be massive tax refunds being due to employers and employees who have paid or received severance over the past few years. According to the IRS data cited in the government’s arguments before the Supreme Court, more than 2,400 tax refund claims have already been filed requesting refunds in excess of \$1 billion.

Pending the outcome of the Supreme Court’s decision, the IRS has suspended action on payroll tax refund claims involving severance payments filed by employers in the Sixth Circuit (Kentucky, Michigan, Ohio, and Tennessee). For employers outside the Sixth Circuit, the IRS is continuing to disallow employers’ refund claims. However, employers both inside and outside of the Sixth Circuit should promptly file amended employment tax returns to preserve their rights. For employers outside of the Sixth Circuit who file a refund claim, if the end of the two-year period for filing a refund suit after a notice of disallowance is approaching, IRS Form 907, Agreement to Extend the Time to Bring Suit, should be filed to extend this deadline.

Individuals laid off in the past three years can file IRS Form 843 to make a refund claim for his/her individual portion of payroll tax overpayments due to receipt of severance. However, the employee should first ask his/her former employer if the company is pursuing a payroll tax refund. Some companies have alerted former workers that they are pursuing a refund, but employers are not required to notify former employees unless the



IRS agrees to pay a claim (which is unlikely until after the Supreme Court decides the Quality Stores case). At that point, the employer generally asks the former workers for consent to include their claims with its own. This sets up a process so that the company can pay former workers their shares of refunded payroll tax. If the individual's former employer did not file a refund claim, then he/she can file IRS Form 843 to make his/her own claim. Note that the individual must make this claim within the statute of limitations, which is generally three years after he/she files the tax return reporting the severance payments. Also note that if a taxpayer is successful and receives a payroll tax refund, the refund is not taxable, but the interest paid on the refund is taxable.

Whether a payroll tax refund is owed to an employer or an individual will be specific to each employer and individual. To determine if you may be entitled to a payroll tax refund and how to best preserve your right to a refund, we encourage all employers to contact Jason Luter at Gray Reed & McGraw jluter@grayreed.com; 469-320-6076.