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The **IRS** is showing no mercy to employers in the wake of the **recent Supreme Court ruling** in the controversial *Quality Stores* case. In a new announcement, it says that it will disallow all claims for refunds of payroll tax relating to severance payments and will not act on appeals that were suspended pending the outcome of the Supreme Court's decision (Ann. 2015-8, 2/9/15). Only claims falling within a narrowly-approved exception will be allowed.

**Here's the rub:** Generally, amounts paid as wages are subject to payroll taxes under the prevailing rates and limits. Both employees and employers have to ante up their fair shares of the taxes. For instance, in 2015 an employee must pay Social Security tax at a 6.2 percent rate on the first \$118,500 of wages and 7.65 percent on amounts above that wage base. The employer has to match each employee's total.

Because severance payments are clearly wages for federal income tax purposes, the IRS has consistently argued that severance paid to terminated workers is subject to payroll taxes. Traditionally, the courts have agreed with the IRS (*CSX Corp. v. U.S.*, Ct. Fed. Claims 3/6/08), but a district court in Michigan reversed the trend in the *Quality Stores* case. It ruled that the payments were akin to supplemental unemployment compensation benefits that were exempt from payroll taxes under Rev. Rul. 90-72. To the surprise of many – including the IRS – the Sixth Circuit Court of Appeals affirmed the decision.

The Sixth Circuit ruling put the IRS in a tight spot. If this outcome was to be applied nationwide, the agency could owe hundreds of million dollars in refunds to employers who had previously paid in payroll taxes on severance packages. So the

IRS appealed to the top court in the land. Going into the showdown, it had already

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payable based on state unemployment benefits or other compensation allowable under state law.

Accordingly, the IRS now says that it will disallow all claims for refunds of payroll taxes on severance payments that don't satisfy the narrow exclusion in Rev. Rul. 90-72. This includes all claims for refund that were suspended pending the resolution of *Quality Stores* and claims filed by taxpayers located within the Sixth Circuit's jurisdiction. Furthermore, the IRS will continue to disallow claims for refund of payroll taxes for such severance payments.

Finally, the IRS says it will take no further action on the appeal requests that were suspended pending the resolution of *Quality Stores*. Case closed.

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