

CSX/SUB-Pay FICA Tax Refunds: Status Update and the April 15 Deadline

April 9, 2009

Today's troubling economic times have caused many employers to turn to a very traditional benefit plan that was commonly used among employers with unionized workforces in the 1950s and 1960s—the supplemental unemployment compensation benefits plan (SUB-Pay). SUB-Pay was originally recognized as an administrative matter by the IRS through a series of revenue rulings, but it is now also defined in the Internal Revenue Code.

While less commonly used today, a carefully crafted SUB-Pay plan can still be an attractive alternative to traditional severance and termination arrangements. Such SUB-Pay plans are used to reduce an employer's out-of-pocket severance costs and to integrate with the employees' state unemployment benefits. As a corollary, SUB-Pay plans can offer significant employer and employee Federal Insurance Contributions Act (FICA) tax savings on the termination payments paid from the SUB-Pay plan. Whether or not an employer decides to prospectively adopt a traditional SUB-Pay plan is an issue that should be carefully considered internally among various tax, human resources, and employment personnel in coordination with counsel.

While such prospective adoption and implementation of any formal SUB-Pay plan should be thoroughly vetted, a simpler alternative may still be available for employers who involuntarily terminated employees prior to 2009. For the last seven years, such employers have routinely filed protective "CSX refund claims." The basis for these claims (which now collectively total several billion dollars) has been the Court of Federal Claims decision in 2002, which held that traditional severance payments constitute SUB-Pay benefits that are exempt from FICA taxes (and Railroad Retirement Tax Act taxes), provided that three basic statutory requirements of Code section 3402(o) are met: (i) plan requirement; (ii) involuntary separation (permanent or temporary); and (iii) reduction in force, plant closing, or other similar condition. *See CSX Corporation, Inc. v. United States*, 52 Fed. Cl. 208 (April 1, 2002).

DEADLINE: Employers that paid significant termination benefits to involuntarily terminated employees in 2005 should file "protective" refund claims no later than Wednesday, April 15, 2009. These protective refund claims can be easily filed in about an hour to preserve any refund rights you may have, and to preserve the statute of limitations.

Importantly, even though the *CSX Corporation* case was reversed last year by the U.S. Court of Appeals for the Federal Circuit (*CSX Corp v United States*, 518 F.3d 1328 (2008)), the dispute over a FICA exemption for involuntary termination plans continues. This is illustrated by a 2008 decision of the Bankruptcy Court in *Quality Stores Inc. v. United States*, 49 Bankr. Ct. Dec. 185 (W.D. Mich. 2008). The Bankruptcy Court adopted the Court of Federal Claims analysis in *CSX Corporation* and specifically declined to change its ruling after the Federal Circuit's reversal last year. The Department of Justice has appealed the Bankruptcy Court's favorable decision and it filed its brief last month.

Because this case will continue to be appealed (through the federal district court and ultimately, the U.S. Court of Appeals for the Sixth Circuit), we recommend that employers continue to preserve any FICA tax refund rights by filing protective refund claims for 2005 (as well as 2006 to 2008) if substantial traditional termination or severance payments were made to involuntarily terminated employees in those years. The decision about whether and how to "perfect" those claims (by identifying the actual disputed amount and collecting employee acknowledgements/consents) can be made in the ensuing months or even years, but the deadline for filing 2005 protective refund claims expires at midnight on Wednesday, April 15, 2009. While the timing is short, such protective refund claims are easy to file (typically taking only one or two hours), even with the recent changes to certain FICA-refund tax forms and procedures.

Morgan Lewis attorneys have handled numerous government and private-sector matters addressing traditional and nontraditional SUB-Pay plans. Our team has worked on more than half of the SUB-Pay rulings issued by the IRS in the last 20 years, and includes two attorneys who led the IRS's initial review and response to the CSX matter in the early 1990s.

If you have any questions about any of the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

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