

**APRIL 14, 2014****U.S. SUPREME COURT DECISION  
A GOOD REMINDER ABOUT SEVERANCE ISSUES**

On March 25, 2014, in the case of U.S. vs. Quality Stores, Inc., the U.S. Supreme Court held that severance payments to employees are “wages” that are subject to FICA withholding (i.e., withholding for Social Security and Medicare taxes). In our experience, it is unusual for employers not to withhold FICA taxes from severance payments, so this ruling (which can be downloaded [here](#)) is probably not surprising to most employers. Nonetheless, the Quality Stores case serves as a general reminder that there are other issues that employers should keep in mind when offering severance payments to departing employees, including the following:

- 1) **Releases of ADEA Claims for Employees who are Age 40 and Over.** Most employers that offer severance payments require departing employees to sign a release of claims in order to receive the severance payments. Not all releases of claims get the job done, however. For employees who are 40 years of age or older, the release of claims is not valid as to claims under the Age Discrimination in Employment Act (the “ADEA”) unless the release of claims includes certain provisions, including the following:
  - The release must be written in a manner that can be clearly understood, using plain language geared to the level of comprehension and understanding of the employee;
  - The release must specifically refer to rights or claims under the ADEA (using the full name of the statute, not its abbreviation);
  - The release must advise the employee to consult with an attorney before accepting the agreement;
  - The release must give the employee at least 21 days (and in some cases 45 days) to consider the release;
  - The release must give the employee 7 days to revoke the employee’s signature on the release; and
  - The release may not cover rights and claims arising after the date the release is signed by the employee.

Additional information from the EEOC about the validity of releases under the ADEA can be found [here](#). Please let us know if you need assistance in drafting a release of claims or would like us to review your existing release of claims template to ensure its compliance with the ADEA’s requirements.

- 2) **Supplemental Wage Withholding.** Severance payments are supplemental wages (like bonuses) and are, therefore, subject to special income tax withholding rules. If the employee receives less than \$1 million of supplemental wages (including severance payments) during the year and the severance payments are not being made at the same time as regular pay, the withholding for federal income tax purposes is a flat 25% (i.e., the normal tax tables are not used). State supplemental tax rates (if there is state income tax) also apply. Section 7 of [IRS Publication 15](#) explains the supplemental tax withholding rules. If you need assistance in determining how to handle income tax withholding on severance payments, please let us know.

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- 3) **W-2 Reporting.** Even though severance payments are being made to former employees, they must be reported on Form W-2, rather than on Form 1099.
- 4) **Code § 409A Issues.** Some severance payments are subject to very strict rules under Section 409A of the Internal Revenue Code ("**Code § 409A**"). If the payments *are* subject to Code § 409A, then the underlying severance plan or agreement needs to be drafted carefully to avoid violating Code § 409A. If severance payments violate Code § 409A, the employee will be subject to hefty penalties, including a 20% penalty tax. Please contact us if you have questions or concerns about whether your severance plans and agreements comply with the requirements of Code § 409A.
- 5) **ERISA Requirements.** Some severance plans and severance arrangements are subject to the Employee Retirement Income Security Act ("**ERISA**"). A severance plan or arrangement that is subject to ERISA must comply with a number of different requirements, including the ERISA plan document requirement, the requirement to provide participants with a summary plan descriptions ("**SPD**"), and the requirement to adhere to the ERISA claims procedures. If you have questions about whether your severance plan or arrangement is covered by ERISA or how to comply with ERISA's requirements, please contact us.

If you have questions or need assistance regarding severance payments, and related issues, please feel free to contact [Jim Spencer](#) or [Trinidad Galdean](#) at (316) 267-2000.