KEELEY, KUENN & REID

Legal Advisory

Employer Severance Payments Are Subject to FICA Taxation

Are severance payments made by an employer to terminated employees – in addition to all wages and other benefits earned for actual work performed – considered taxable "wages" for purposes of the rules governing Social Security taxes under the Federal Insurance Contributions Act (FICA)? Resolving a split among the federal appeals courts, the U.S. Supreme Court unanimously ruled that severance payments that are not linked to state unemployment benefits are taxable wages for FICA purposes. (*U.S. v. Quality Stores, Inc.*, No. 12-1408).

The severance payments in this case were made by Quality Stores to employees terminated against their will, were varied based on job seniority and time served, and were not linked to the receipt of state unemployment benefits. The employer paid its portion of the social security taxes on the severance payments and withheld the employees' portion of such taxes. Subsequently, Quality Stores filed for a refund of its payments and the sum withheld from the terminated employees. In interpreting FICA's broad definition of "wages", the Supreme Court reversed the 6th Circuit federal appeals court and ruled that these severance payments constitute taxable wages for FICA purposes.

U.S. Supreme Court Expands Sarbanes-Oxley Whistleblower Protection for Employees

In a 6-3 decision, the U.S. Supreme Court held that the employee "whistleblower" provisions in the Sarbanes-Oxley Act ("SOX") extends to employees of *privately-held* contractors and subcontractors working for *publically-held* companies. (*Lawson v. FMR, LLC*, No. 12-3). Passed in 2002, in the wake of the Enron collapse, SOX includes a provision barring retaliation against employees of companies who: report certain types of allegedly unlawful conduct to federal authorities or to their employer; or otherwise assist in the investigation of such conduct. The relevant section of the law reads in part:

> "No [public] company..., or any officer, *employee*, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of [whistleblowing or other protected activity]."

The Court, reversing the 1st Circuit federal appeals court, ruled that "employee" in the statute quoted above protects any employee of a privately-held contractor or subcontractor to a public company. Contractors and subcontractors may include consultants, advisors, attorneys, accounting firms, auditors and others.

In this case, several employees of privately-held service providers to a public mutual fund company were discharged by their employers for allegedly raising concerns about fund accounting practices and the accuracy of statements made in a draft Securities and Exchange Commission registration filing. The Supreme Court rejected the service provider's argument that the SOX provision only applies to employees of public companies.

EEOC Loses Appeal on Challenge to Employer Use of Credit History to Screen Job Applicants

Appellate court opinions can be lengthy and often don't signal the outcome of the ruling early on. The 6th Circuit federal appeals court decision in *Equal Employment Opportunity Commission v. Kaplan Higher Education Corp.* is the exception. The first sentence in the opinion reads: "In this case the EEOC sued the defendants for using the same type of background check that the EEOC itself uses."

Further, the EEOC's personnel handbook recites that "[o]verdue just debts increase temptation to commit illegal or unethical acts as a means of gaining funds to meet financial obligations." Because of this declared concern, the EEOC acknowledged in court that it runs credit checks for 84 of the agency's 97 positions.

In this case the EEOC alleged that Kaplan's use of credit checks for select positions causes it to screen out more minority applicants than non-minority applicants, creating a "disparate impact" in violation of Title VII of the federal Civil Rights Act. To prove disparate impact, the agency relied solely on statistical proof in the form of expert testimony by a single witness. The district court excluded this expert testimony as unreliable and dismissed the case. Federal evidence rules require expert testimony to be offered by a qualified individual in the form of an opinion based on facts and data using reliable principles and methods that are generally accepted in the scientific community.

In affirming the dismissal, the appeals court agreed that the expert's methodology did not meet any of the factors that federal courts typically consider in determining the reliability of expert testimony. Also relevant was the expert's own admission that the sample of rejected job applicants he used was not representative of Kaplan's applicant pool as a whole.

Employers are well advised to obtain legal review of any use of credit reports for employment purposes, to assure compliance with federal and state discrimination laws and the federal Fair Credit Reporting Act. In addition, a number of state laws have been passed that regulate or restrict the use by employers of credit reports and credit history information for hiring and other employment-related purposes.

NLRB Rejects Policies in Employer Handbook

It has become almost routine for the NLRB to review, revise, and remove policies the Board deemed overly broad from employer handbooks. Recently, the Board upheld the decision of an Administrative Law Judge that three provisions of the handbook violated an employee's rights under Section 7 of the National Labor Relations Act (*Hill and Dales General Hospital and Danielle Corlis* (Case 07-CA-053556)).

The three provisions of the handbook:

- Prohibited employees from making negative comments about "fellow team members".
- Prohibited employees from engaging or listening to negativity or gossip.
- Required the employees to represent the company in the community in a positive and professional manner.

In reviewing these provisions the Board followed its standard set out in *Lutheran Heritage Village-Livonia* (343 NLRB 646, 2004). The standard provides that even where the policy does not clearly restrict Section 7 activity, it may still be found unlawful if: (1) employees would reasonably construe the language to prohibit Section 7 activity; (2) the rule was promulgated in response to union activity; or (3) the rule has been applied so as to restrict the exercise of Section 7 rights. The Board upheld the ALJ's decision as to the three provisions. It also rejected the Company's argument that because employees of the Company were involved in developing the rules there would not be any ambiguity as to the meaning and purpose of these rules.

Employers are well advised to consult with their counsel when preparing or amending employee handbooks to ensure compliance with Section 7 of the Act. This section applies to all employers and its application is not confined to companies that unionized.