

Employee's Settlement Proceeds from age Discrimination Dispute Subject to FICA Tax Withholding

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After the financial services employee was terminated, he filed a charge with the Equal Employment Opportunity Commission, claiming that his employer discriminated against him in violation of the Age Discrimination in Employment Act and New York state law. The parties ultimately resolved the dispute for \$250,000. When making the payment, the employer withheld taxes pursuant to the Federal Insurance Contribution Act (FICA). The employee claimed that this was improper and filed suit, seeking a refund of the \$4,218 withholding.

The district court held that the money paid to the employee constituted “wages,” and was therefore properly subject to the FICA taxes, and dismissed the employee’s complaint. The employee appealed, and the Second Circuit Court of Appeals affirmed. Ultimately, because the funds were payments received “with respect to employment” under 26 U.S.C. §3121, the Court concluded they were subject to the tax.

Figuring out the taxability of settlement proceeds can be tricky for employees and employers alike. Many times, the language of the settlement agreement may govern the conduct of the parties, but may not insulate the parties from potential tax liability with the Internal Revenue Service. Employers who resolve disputes with employees must take caution to comply with state and federal law regarding tax liabilities with respect to those payments, especially when they may be deemed to be “wages” under the applicable law.

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