O'NEILL & BORGES, LLC

LABOR & EMPLOYMENT ALERT

DEVELOPMENTS IN LABOR RELATIONS & EMPLOYMENT LAW FOR PUERTO RICO

April 2014

U.S. Supreme Court Rules Most Severance Payments Are FICA Taxable

Jorge L.Capó-Matos

On March 25, 2014, the United States' Supreme Court held severance payments to an employee involuntarily terminated and that was not linked to a plan which conditioned the payments to the former employee's receipt of state unemployment benefits, are taxable under the Federal Insurance Contributions Act ("FICA"). *United States v. Quality Stores, Inc.*, No. 12-1408.

In *Quality Stores*, the employer had closed several establishments and discharged thousands of employees. The employer provided the discharged employees severance payments pursuant to the terms of two termination plans, which established different severance amounts based on seniority, job grade, and management level (among other factors). Quality Stores paid its share of FICA (social security) taxes and withheld the employees' FICA contribution from the severance benefit. The employer subsequently filed FICA tax refund claims for itself and on behalf of the former employees with the Internal Revenue Service (IRS) for an amount in excess of $1 million dollars.

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"the* Quality Stores *specific holding and analysis invalidates the Puerto Rico's Supreme Court decision which held discharge compensation under Puerto Rico's Wrongful Discharge Act is not subject to FICA taxation."

More Workplace Anti-Bullying Bills Filed

Alberto J. Bayouth-Montes &
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Our January 2014 "*Labor & Employment Law Alert*" discussed *Senate Bill 501*, which proposes to impose upon employers the obligation to prohibit, prevent and remedy all forms of unjustified harassment and bullying in the workplace. The proposed law will broadly prohibit all types of oppressive or harassing conduct in the workplace -not only bullying- and impose significant liability on the employer for failing to ensure a non-harassing work environment.

Senate Bill 501 does not stand alone. Several other workplace anti-harassment or bullying bills are also being considered by the local legislature. Among the more advanced is *House Bill 79*, which received a committee positive report and has been placed on the Calendar for Special Matters.

The most recent entry is *House Bill 1621*. Unlike *Senate Bill 501*, this new attempt at curbing workplace bullying imposes a much higher burden upon claimants.

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When the IRS failed to address the employer's request, Quality Stores initiated a refund proceeding in the bankruptcy court, which granted judgment in its favor. On appeal, both the federal district court and the Sixth Circuit Court of Appeals ruled in favor of Quality Stores. The Sixth Circuit held the severance payments should not be treated as "wages" subject to FICA taxes because they qualified as exempt *supplemental unemployment compensation benefits ("SUBs")* as defined by Internal Revenue Code. The Supreme Court disagreed and reversed.

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The Court commenced its analysis by indicating FICA defines "wages" broadly as "all remuneration for employment." Secondly, the Court held that as a matter of plain statutory meaning, severance payments fit this definition. Third, the Court noted that since 1946, it had had interpreted the term "wages" under FICA applied to compensation in wrongful discharge claims. Fourth, the Court found the broad definition of the term "wages" under FICA, reinforced by the specificity of the statute's lengthy list of exemptions, a list which does not include severance payments, supports including severance payment under the term "wages." Finally, the Court recognized the IRS had ruled since 1936 the statutory definition of "wages" included "dismissal pay" for FICA purposes.

In passing, the Court also emphasized the severance payments in this case were *not SUBs* tied to an employer plan which conditioned severance benefit entitlement to the former employee's concurrent receipt of unemployment benefits under state law. The Court recognized that since the 1950's the IRS has held severance benefits paid under such SUB plans are not "wages" under FICA and the agency has not yet overturned such rulings.

This decision entails several consequences for Puerto Rico. First, the *Quality Stores* specific holding and analysis invalidates the Puerto Rico's Supreme Court decision which held discharge compensation under Puerto Rico's Wrongful Discharge Act is not subject to FICA taxation. See, *Alvira v. SK & F Laboratories*, 142 D.P.R. 803 (1997)(referring to Law No. 80 of May 30, 1976, as amended).

Secondly, considering the IRS still exempts SUBs from FICA taxation, employers may wish to consider redesigning their severance plans. Instead of the typical "lump sum" severance payment, some employers may move to establishing severance plans integrated with the receipt of unemployment benefits.

Employers interested in adopting SUB type severance programs need to carefully review the IRS multiple requisites for SUBs exemption, as well as potential ERISA notification and administrative obligations. O'Neill & Borges, LLC is available for further guidance.

Finally, if the FICA exemption for supplemental unemployment compensation benefits is coupled with Puerto Rico's income tax exemption for severance payments granted in the context of workforce reductions, reorganizations, total or partial closing of operations covered by Puerto Rico Law No. 278 of August 15, 2008, a well-designed severance program may maximize the former employee's income.

SUB plans also have the potential of reducing the former employer's total payout, since the severance/supplemental unemployment compensation benefits terminate if the employee is reemployed or otherwise stops receiving unemployment benefits.

Drug Testing Alert: Things Are Getting Complicated

Jorge L.Capó-Matos &
Joanna Matos-Hicks

The Supreme Court of Puerto Rico recently held an employer lacked *"just cause"* under Puerto Rico's Wrongful Discharge Act, Law No. 80 of May 30, 1976, as amended, even though the discharge was based on the employee testing positive for cocaine use because the test was made using the employee's *hair* sample, instead of a *urine* sample, which is generally contemplated by Puerto Rico's Private Sector Drug Testing statute, Law No. 59-1976. *Orlando Ortiz v. Holsum de Puerto Rico, Inc.*, 2014 TSPR 35 (March 7, 2014)

The *Ortiz* decision is the first opinion in which the Supreme Court interprets Puerto Rico's "*Law to Regulate Testing for Controlled Substances in the Private Labor Sector.*" In doing so, the Court has imposed requirements that are not clearly derived from the statute. How the Court analyzed Law No.59 should provide guidance on how to resolve other issues that arise in the context of drug testing.

Pursuant to the employer's drug testing policy, Ortiz was required to provide a urine sample. The test result was discarded as "*inconclusive*" because the sample was diluted. A second sample was required and came back negative. The following year, Ortiz was tested and the results came back *positive* for cocaine. Holsum provided Ortiz the opportunity to enter a rehabilitation program and advised he would be discharged in the case of a second positive result.

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House Bill 1621 defines workplace "mobbing" as an extreme psychological violence that is systematically and recurrently exercised against a fellow coworker for an extended period of time. Also, for "mobbing" to occur it must have the following four consequences: (1) the victim's communication network must be destroyed; (2) the victim's reputation must be destroyed; (3) the victim's work performance must be affected; and (4) the victim must abandon the workplace.

House Bill 1621 appears to be a more cautious and balanced approach to address workplace bullying and harassment. Unfortunately, the bill's sponsor is a minority party rookie legislator. In the political arena, this normally means he will need to work hard to muster support for his bill.

Given the draconian nature of the other workplace anti-bullying bills pending before the Legislature, employers and employer associations may find it advantageous to examine and possibly support *House Bill 1621*, as a less harmful alternative. Similarly, those favoring this type of legislation may find *House Bill 1621* to be a feasible alternative, since it should not encounter the same degree of opposition from business groups.

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Eleven months later (23 months from the first drug test), Ortiz was required to submit to another drug test based on a urine sample. The laboratory found the sample had been diluted, but this time described the results as "*invalid.*" A second test on a new urine sample was required of the employee a few days later and the results were *negative*. To obtain a more definite test result, a few weeks later but *after* the expiration of the one year anniversary of the prior cocaine test results, the employer required Ortiz to provide a *hair* sample. This time the test results were returned *positive* for cocaine. Pursuant to its rules of conduct, since this was a second positive result, Holsum proceeded to discharge the employee.

Ortiz filed a wrongful discharge claim against Holsum. The employer requested the summary dismissal of the complaint, alleging "just cause" for Ortiz' discharge and that it had fully complied with Law No. 59. The trial court denied the employer's request, holding Law No. 59 did not permit submitting employees to more than two drug tests per year. The trial court further held that even if the diluted sample after the positive cocaine result was discarded as attributable to the employee, the subsequent result came back *negative*. Having been tested twice in the prior year, the employer was not authorized to require a third test. The Court of Appeals sustained the trial court's decision to deny the employer's request for summary dismissal of the complaint.

Holsum requested review by the Puerto Rico Supreme Court. The Supreme Court also sustained the trial court's decision, but only on the following grounds:

First, the Court held that private sector employers wishing to maintain drug testing programs must comply with the requirements of Law No. 59.

Second, the Court held Law No. 59 only authorizes testing of *urine* samples, unless taking such a sample is not possible in the particular circumstances.

Third, since Law No. 59 indicates testing will be administered in accordance to the "*Mandatory Guidelines for Federal Workplace Drug Testing Program*," the circumstances under which a drug test can be administered using a bio specimen other than a urine sample must comply with said federal regulation.

According to the Court, the federal regulation only permits deviating from a urine sample when there are documented medical reasons that render a urine sample i*mpossible*; and generally, said medical condition must be permanent or of a prolonged duration. Such a circumstance was not present in this case, thus rendering the invalid the hair sample test and its results.

Fourth, since requiring the employee's hair sample was invalid, the positive test result for cocaine could not be taken into consideration by the employer.

Accordingly, the Court held Holsum was unable to establish it had "just cause" under Puerto Rico's Wrongful Discharge statute to dismiss Ortiz on the basis of the test results.

The *Ortiz* decision is expected to impact and change local employers' approach to drug testing. By requiring private sector employers to comply with regulations designed for federal government employee drug testing, the Court has imposed a level of safeguards and complexities previously deemed inapplicable.

Employers will be well advised to reexamine their drug testing programs particularly in light of the *"Mandatory Guidelines for Federal Workplace Drug Testing Program."*

Note: *Because of the general nature of this Labor Newsletter, nothing herein should be considered as legal advice or a legal opinion. For further information, please contact our labor and employment lawyers.*

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