Sick Pay Subject to FICA Tax

For the First Six Months of an Employee’s Disability, the Sick Pay is Subject to FICA Tax

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On December 16, 1981, the Omnibus Reconciliation Act of 1981 was passed into law. The new law imposes Federal Insurance Contribution Act (FICA) taxes on payments made to an employee or any of his dependents under a qualified plan on account of the employees’ sickness or disability during the first six months the employee is off work.

The Act accomplishes this change by expanding the definition of “wages” to include those payments made under a qualified plan for sickness or disability. Workers’ compensation payments and payments made more than six months after an employee last worked will not be subject to FICA taxes. There is also no FICA taxes imposed on the amount which an employee has been required to contribute to the plan.

The new law also requires third-parties who make payments under a qualified plan to withhold FICA taxes on those payments. But, if the third-party withholds the employee portion of the tax, deposits it as normally required, and notifies the employee’s normal employer of the amount of the payments which have been made to the employee, the burden of paying the employer portion of the FICA tax then shifts to the employer.

The Act expressly provides that it does not apply with respect to payments made by a third-party to an employee pursuant to a contractual relationship between the employer and the third-party which was entered into before December 14, 1981 if—(a) coverage by the third-party for the group in which the employee falls ceases before March 1, 1982, and (b) no payment by such third-party is made to such employee under such relationship after February 28, 1982. The implication of this provision seems to be to encourage employers to attempt to change their plans with third-parties such as insurance companies and unions, to take into account the new level of expenses which will be incurred by the employer while the third-party is furnishing disability payments to the employee.

It should be noted that the Act expressly provides that employers and third-party payors will not be subject to penalties or interest because of their failure to comply with this new law until July 1, 1982, unless their failure to comply is due to willful neglect and the absence of an exercise of reasonable care.

While the Act definitely imposes a new burden of taxation upon employers, it does not directly alter any obligations of either party to a contract which provides for a fixed contribution benefit plan. In fact, the employer’s contribution to the plan is still fixed, and the third-party’s liability to eligible employees under the plan also remains the same. Therefore, the change resulting from the Act is the levy of an additional tax on the employer under the Federal Insurance Contributions Act.