

New Jersey Labor and Employment Law Quarterly

Vol. 29 No. 2 Winter 2007

TABLE OF CONTENTS

COMMENTS FROM THE CHAIR	1
<i>by Arnold Shep Cohen</i>	
EDITORIAL BOARD	3
Table of Contents	3
EDITOR-IN-CHIEF'S COLUMN	4
<i>by Keith Waldman</i>	
THE OFFER OF JUDGMENT RULE IS NECESSARY TO COMBAT THE MISUSE OF THE LAD'S FEE-SHIFTING PROVISION	6
<i>by Eric A. Savage and Frank A. Custode</i>	
THE WORKER FREEDOM FROM EMPLOYER INTIMIDATION ACT: PANACEA OR CONSTITUTIONAL TRAIN WRECK?	8
<i>by Jed Marcus</i>	
THE THIRD CIRCUIT ADOPTS A BROAD READING OF THE 'MINISTERIAL EXCEPTION'	11
<i>by M. Trevor Lyons</i>	
ELEMENTS OF AN EFFECTIVE HARASSMENT INVESTIGATION ..	14
<i>by Suzanne M. Cerra</i>	
LIMITS ON THE DUTY TO WITHHOLD EMPLOYMENT TAXES FROM LOST WAGES	17
<i>by Andrew M. Moskowitz</i>	
ACCOMMODATIONS FOR ATTORNEYS WITH DISABILITIES	19
<i>by Corrado Gigante</i>	

EDITORIAL BOARD

Editor-in-Chief

Keith Waldman, Mt. Laurel

Managing Editor

Brett M. Reina, Morristown

Editors

Anne Ciesla Bancroft, Princeton

Steven M. Berlin, Newark

Mark J. Blunda, Warren

Suzanne M. Cerra, Basking Ridge

Anthony J. Cincotta, Shrewsbury

Janice G. Dubler, Cherry Hill

Kathleen A. Dunnigan, Newark

Christina Silva, Roseland

M. Trevor Lyons, Roseland

Lisa Manshel, Millburn

David A. Rapuano, Haddonfield

Thomas M. Toman Jr., Red Bank

Jerrold J. Wohlgenuth, Newark

Editors Emeritus

James F. Schwerin, Lawrenceville

Anthony P. Limitone, Morristown

Margaret M. Madden, New York

Domenick Carmagnola, Morristown

Arnold Shep Cohen, Newark

Charles F. Waskevich Jr., Warren

LIMITS ON THE DUTY TO WITHHOLD EMPLOYMENT TAXES FROM LOST WAGES

by Andrew M. Moskowitz

The conventional wisdom regarding the tax treatment of awards and settlements in employment cases has been stated as follows: "The entire award, other than the portion attributable to a physical injury, is subject to income tax...[and] the wages portion is subject to employment taxes..."¹ However, some courts have held that, because no current employer-employee relationship exists, the portion of an award or settlement allocated to "lost wages" is not subject to withholding under federal and state tax laws. In addition, because the Family and Medical Leave Act (FMLA)² provides that a successful plaintiff may recover damages "equal to" his or her lost wages, some courts have determined that an award or settlement in a FMLA case does not constitute wages.

Discussion

Federal law requires an employer to withhold from an employee's wages federal income tax and FICA taxes.³ The Internal Revenue Code defines the term "wages" as "remuneration for employment..."⁴ In turn, "employment" is defined as "any service, of whatever nature, performed by an employee for the person employing him..."⁵

Absence of Employer-Employee Relationship

Several courts have reasoned that an award or settlement in an employment case does not constitute wages subject to withholding because, during the relevant time period, the plaintiff was not an employee of the defendant. For example, where a plaintiff who alleged that his termination violated the New Jersey Law Against Discrimination (NJLAD)⁶ was awarded \$60,000 in damages for "lost past income," the court held that the award

"d[id] not constitute wages subject to withholding..."⁷ In so holding, the court observed that "no employer-employee relationship existed as plaintiff had been terminated."⁸

Similarly, in a recent opinion, a federal district court relied on this rationale and noted that, due to the absence of "an employee/employer relationship...at the time...that the loss of 'back pay' occurred," the portion of the settlement allocated to the plaintiff's economic loss was not wages subject to withholding.⁹ In *Churchill v. Star Enterprises*, the court acknowledged that its holding expressly contradicted IRS rulings and a regulation requiring defendants "to withhold taxes from [a] plaintiff's back pay award."¹⁰ Indeed, Revenue Ruling 78-176 had determined that, where parties had brought Title VII claims and stated that they "suffered economic loss as a result of a wrongful refusal to hire," payments made pursuant to a consent decree were "wages" subject to withholding. However, in *Churchill*, the court determined "that these Revenue Rulings expressly contradict the language of the [Internal Revenue Code]...[and] we are bound to follow the plain language of the statute."¹¹

It should be noted that the Ninth Circuit disagrees with the above court's interpretation, having determined that settlement proceeds representing lost wages were subject to withholding in a Title VII case.¹² In addition, the Fourth, Sixth, and Eighth circuits have held that settlements arising out of Employee Retirement Income Security Act (ERISA) claims were subject to income and employment taxes.¹³

FMLA: Damages Equal to Lost Wages

Some courts also have relied on the FMLA's use of the term "damages equal to wages" as an additional basis

for determining that FICA taxes need not be deducted from FMLA awards or settlements. Indeed, unlike Title VII, which states that a court may award a plaintiff "back pay,"¹⁴ the FMLA provides that a successful plaintiff may recover "damages equal to—(i) the amount of—(I) any wages, salary, employment benefits, or other compensation denied or lost to such employee by reason of the violation."¹⁵ "Th[is] phraseology of 'equal to the amount of'...is unique as compared with other employment discrimination statutes."¹⁶

Like the FMLA, the NJLAD does not use the term "back pay." Instead, it states only that plaintiffs may recover compensatory and punitive damages.¹⁷

Conclusion

Until a higher court such as the Third Circuit or the United States or New Jersey Supreme Court rules on the applicability of withholding requirements to employment awards and settlements, it is difficult to say how practitioners should advise clients on this issue. However, at a minimum, we should make clients aware of the conflicting law on this topic. ■

Endnotes

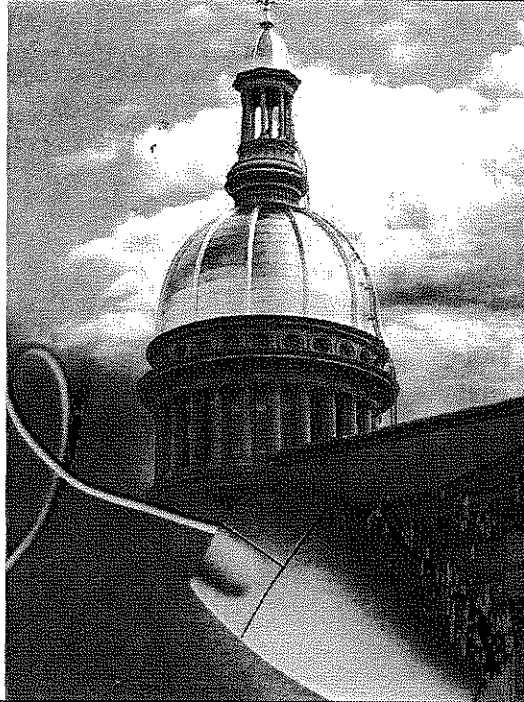
1. Steven I. Adler, Jeffrey H. Schechter and Randi W. Kochman, *Taxation Without Representation*, N.J.L.J. (March 25, 2002).
2. 29 U.S.C. § 2601 *et seq.*
3. 26 U.S.C. § 3402(a). *See also* N.J.S.A. 54A:7-1(a) (imposing similar withholding obligation for state income tax).
4. 26 U.S.C. § 3121(a).
5. 26 U.S.C. § 3121(b).
6. N.J.S.A. § 10:5-1 *et seq.*
7. *Sang-Hoon Kim v. Monmouth College*, 320 N.J. Super. 157, 159 (Law Div. 1998).

8. *Id.*
9. *Carr v. Fresenius Medical Care*, Civ. No. 05-2228, 2006 WL 1339970, at *3 (E.D. Pa. May 16, 2006). See also *Churchill v. Star Enterprises*, 3 F. Supp. 2d 622 (E.D. Pa. 1998) (where plaintiff asserted that she was terminated in violation of FMLA, part of verdict allocated to lost wages not subject to withholding).
10. *Churchill*, 3 F. Supp. 2d at 625

(citing Revenue Rulings 72-341 and 78-176 and 26 C.F.R. § 31.3121).

11. *Id.* at 625.
12. See *Rivera v. Baker West, Inc.*, 430 F.3d 1253, 1259 (9th Cir. 2005).
13. *Hemelt v. United States*, 122 F.3d 204, 209 (4th Cir. 1997) (finding that settlement payments for ERISA claims “fit easily within FICA’s broad definition of ‘wages’ as ‘all remuneration for employment unless specifically excepted...’”) (quoting 26 C.F.R. § 31.3121(a)-1(b)); *Gerbec v. United States*, 164 F.3d 1015, 1025, 1026 (6th Cir. 1999) (portion of settlement “that falls within the definition of wages under FICA are subject to FICA taxation”); *Mayberry v. United States*, 151 F.3d 855, 860 (8th Cir. 1998) (settlement proceeds “constituted ‘wages’ within the meaning of the statutory wage tax provisions, and FICA taxes were properly withheld”).
14. 42 U.S.C. § 2000e-5(g)(1).
15. 29 U.S.C. § 2617(a)(1).
16. *Carr*, 2006 WL 1339970, at *1 (quoting *Longstreth v. Copple*, 101 F. Supp. 2d 776, 780 (N.D. Iowa 2000)).
17. N.J.S.A. 10:5-3. See also N.J.S.A. 10:5-13 (stating that “[a]ll remedies available in common law tort actions shall be available to prevailing plaintiffs”).

The New Jersey State Bar Association, the state’s largest association providing programs and services to the legal profession, offers easy access to association services, programs and information through its website...



www.njsba.com

- Find out what the NJSBA is doing for you and other attorneys in the state—visit our home page, judicial administration, government relations, and legal affairs sections.
- Join the NJSBA and its more than 30 sections and divisions.
- Visit our Member Benefits Section where you will find information about NJCitrineSM, a customized FREE legal research tool; ICLE discounts; law office management resources; member insurance information; discounts on copying, floral arrangements, clothing and more.
- View the meetings calendar and register online for section, committee and division meetings.
- Access links to state and federal government and courts, New Jersey State Legislature, county and state bar associations, law schools, other legal associations and legal research.

Tell us what you would like to see — e-mail info@njsba.com.



Andrew M. Moskowitz practices plaintiff’s employment law at Deutsch Atkins in Hackensack.