

FICA Exemption Policy

Policy:

Any payment on account of sickness made by an employer to an employee after the expiration of six calendar months following the last calendar month in which the employee worked will not be considered wages subject to FICA taxes.

Procedures:

The Payroll Office will "turn off" the FICA deduction for an employee who is on sick leave for more than six months after the last month worked. The payments not subject to FICA taxes after six months include any payment made "on account of" sickness. These payments include sick leave pay and may include other payments (such as annual or compensatory leave) for leave to extend income received by the employee when the employee's sick leave balance is exhausted. The use of these additional leave balances is "on account of" sickness, not due to vacation, etc. The 6-month sick leave period must be continuous, otherwise, the start date for beginning the documentation of the six months period re-sets each time the employee returns to work.

If an employee receives "leave sharing" after the 6-month sick leave period, this pay would also qualify for the FICA exemption.

If an employee decides to retire at the end of the 6-month period, all leave balances paid-off are subject to FICA taxes. The FICA exemption mentioned above is effective only when sick leave is being extended for current employees.

References

1. Memorandum from Evelyn Steele, State Payroll/Benefits Manager, dated 7/13/94; subject "Withholding of FICA Tax on Sick Pay".
2. Phone call to David Von Moll, State Payroll Manager, March 1999. He said that in his opinion, the use of annual or compensatory leave balances to extend pay after an employee's sick leave is exhausted should qualify for the "after 6-month FICA exemption". That use of annual or compensatory leave balances should not matter because it is being used as if it was sick leave. It does not matter which pool of leave is being used, the pay is still due to a sickness. Also, if the employee is retiring, any pay-off is FICA taxable.
3. Phone call to and e-mail from Jerry Smith, CPA, Radman, Jones and Smith. He said we should apply FICA to these payments, "...payments made to a former employee are subject to employment taxes if they would have been paid had the employment relationship terminated for reasons other than death or disability retirement. These payments therefore are considered wages subject to FICA and FUTA taxes." Reference came from RIA, Payroll explanation and analysis. In my opinion, he was referring to former employees when the question posed was referring to current employees on leave.
4. **Circular E**, page 17, #7, Sick Pay Reporting states "sick pay generally means **any amount paid** under a plan because of an employee's temporary absence from work due to injury, sickness, or disability. Sick pay may also be payments **on account of** sickness or accident disability." Also, Page 19, #5, Payments after 6 months absence from work, states "social security, Medicare and FUTA taxes do not apply to **sick pay** paid more than 6 calendar months after the last calendar month in which the employee worked." Analysis: The definition of sick pay suggests that **any amount paid** could include annual and/or compensatory leave paid **on account of sickness**. FICA does not have to be paid for **sick pay** received after a 6-month sick leave absence. Therefore, no FICA should be paid on pay received due to sickness after a 6-month sick leave absence.