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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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REVISED ACTION ON DECISION

Subject: North Dakota State University v. United States,
255 F.3d 599 (8th Cir. 2001), nonacq., 2001-2 C.B. xv

Issue:

Whether early retirement payments that the taxpayer made to tenured faculty members are wages subject to Federal Insurance Contributions Act ("FICA") taxes.

Discussion:

In an Action on Decision published December 31, 2001, the Service did not acquiesce in the Eighth Circuit's decision in North Dakota State University v. United States. Nevertheless, the Service recognized the precedential effect of the decision to cases appealable to the Eighth Circuit, and acknowledged that it would follow the decision within the Eighth Circuit with respect to cases that had the exact facts of North Dakota State University. The Service's nonacquiescence in the Eighth Circuit's decision remains unchanged. However, the Service is modifying its litigating position with respect to cases involving early retirement payments to tenured faculty members made by taxpayers in the Eighth Circuit on or after January 12, 2005.

When the Eighth Circuit held that a payment made to a tenured faculty member under North Dakota State University's early retirement program was made in exchange for the relinquishment of the tenured faculty member's contractual and constitutionally protected tenure rights rather than as remuneration for services to the University, it cited Rev. Rul. 58-301, 1958-1 C.B. 23, as support for its decision. In Rev. Rul. 58-301, a worker was employed under a written contract providing for five years of employment. During the second year of employment, the worker and firm agreed to cancel the remaining period of the contract. In consideration of the worker's relinquishment of contract rights, the firm paid a lump sum payment to the worker. The IRS concluded in

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this ruling that the lump sum payment received by the worker was not wages for FICA and Federal income tax withholding purposes. For the reasons set forth in our earlier Action on Decision, we disagree with the court's analysis that the case was analogous to Rev. Rul. 58-301.

On December 13, 2004, the Service issued Rev. Rul. 2004-110, 2004-2 C.B. 960, which modified and superseded Rev. Rul. 58-301. Rev. Rul. 2004-110 holds that an amount paid to an employee as consideration for the cancellation of an employment contract and relinquishment of contract rights is ordinary income and wages for purposes of FICA, the Federal Unemployment Tax Act (FUTA), and Federal income tax withholding. Rev. Rul. 2004-110 states that Rev. Rul. 58-301 erred in its analysis by failing to apply the Code and regulations appropriately to the question of whether the payments made in cancellation of the employment contract were wages. For this reason, Rev. Rul. 58-301 is modified and superseded. However, under the authority of section 7805(b), if a payment is made under facts and circumstances that are substantially the same as in Rev. Rul. 58-301, the Service is applying Rev. Rul. 2004-110 only if the payment is made on or after January 12, 2005.

The Service is modifying its Action on Decision with respect to North Dakota State University to reflect the change in its published rulings. The Service will follow North Dakota State University within the Eighth Circuit only with respect to cases that have the exact facts as that case and only to the extent that payments were made before January 12, 2005 -- that is, during the period of time when the Service made relief available to cases falling under Rev. Rul. 58-301. Consistent with the original Action on Decision, the Service will continue to litigate cases in the Eighth Circuit involving early retirement payments but otherwise having different facts from North Dakota State University regardless of when the payments were made. Moreover, the Service will continue to take the position that early retirement payments made to tenured professors are remuneration for services subject to FICA taxes in all cases in other circuits.

Recommendation:

Nonacquiescence.

The litigating position in the Action on Decision dated December 31, 2001, is modified and replaced by this Action on Decision.

Reviewers:

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