

**INTERNAL REVENUE SERVICE**

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August 30, 2000

The Honorable Phil Gramm  
United States Senate  
Washington, D.C. 20510

Dear Senator Gramm:

This letter is in reply to your inquiry dated July 26, 2000, on behalf of your constituent, Mr. [REDACTED]. Mr. [REDACTED] has been receiving severance pay from his former employer since his retirement in 1993. He is concerned that his employer is currently deducting Federal Insurance Contributions Act (FICA) taxes, commonly referred to as social security and Medicare taxes, from the severance pay.

Although the information submitted does not contain the terms of the plan under which Mr. [REDACTED] is receiving payments, it appears that his employer may have been treating the payments as nonqualified deferred compensation under a transition rule in final regulations under section 3121(v) of the Internal Revenue Code. See Treasury Regulations section 31.3121(v)(2)-1 and 31.3121(v)(2)-2.

If the amounts paid by his employer are severance pay, severance pay is subject to social security and Medicare taxes when paid. The taxes apply regardless of when the services were performed. There has been no change in the law on January 1, 2000, that would affect the social security and Medicare taxation of severance pay.

In Cohen v. United States, 63 F.Supp.2d 1131 (C.D. Cal. 1999), the United States District Court for the Central District of California held that severance pay paid by an employer to a former employee in 1994, 1995, 1996, and 1997, was wages subject to social security and Medicare taxes when paid.

I hope this information is helpful to you in responding to your constituent. If you have further questions, please call me or Alfred G. Kelley (Identification Number 50-03882) at (202) 622-6040.

Sincerely,  
Mary Oppenheimer  
Assistant Chief Counsel  
(Exempt Organizations/Employment Tax/  
Government Entities)