

INTERNAL REVENUE SERVICE

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The Honorable Debbie Stabenow
United States Senator
243 West Congress Street
Suite 550
Detroit, MI 48226

Attention: Bridget Johnson

Dear Senator Stabenow:

This letter is in response to your inquiry addressed to the Taxpayer Advocate (copy enclosed) dated April 1, 2004, on behalf of your constituent, . said that when he retired last spring from teaching, he received a severance incentive payment for resigning and giving up his tenure rights. He said this payment is not earnings and questioned why he has to pay Federal Insurance Contributions Act (FICA) taxes on this retirement payment. He referred to an unnamed recent Federal Circuit Court of Appeals case that he believes supports his view. Although I do not have enough information to discuss specific circumstances, I can provide the following general information.

The tax law imposes FICA taxes on wages, which includes all payments made as remuneration for employment, unless specifically excluded from FICA coverage. Employment for FICA purposes means any service, of whatever nature, an employee performs for the person employing him. In *Social Security Board v. Nierotko*, 327 U.S. 358 (1946), the Supreme Court interpreted the term "service" broadly under the Social Security Act (the benefits legislation corresponding to FICA) to mean not only work actually done, but the entire employer-employee relationship for which compensation is paid to the employee by the employer. The same words used in the FICA and the Social Security Act are presumed to have consistent meanings, provided that such consistency serves the distinct purposes of the statutes, namely, tax collection and provision of benefits.

The tax regulations provide that the name used to describe the remuneration is immaterial. The tax regulations also generally provide that remuneration constitutes wages even though the relationship of employer and employee no longer exists at the

time paid. Thus, the fact that a payment is called a severance incentive payment or is made after termination of employment does not change its characterization as wages.

Additionally, the Federal Circuit court case we believe _____ referred to is *North Dakota State University v. United States*, 22 F.3d 599 (8th Cir. 2001). The case involved, in part, payments to professors for relinquishing formal tenure rights. The IRS issued an Action on Decision (AOD) on December 31, 2001, to explain the IRS' position on university faculty early retirement payments.

In this AOD, the IRS disagrees with the Eighth Circuit's decision that early retirement payments made by a university to its tenured faculty members for the relinquishment of their tenure rights were not wages and, therefore, not subject to FICA taxes. The AOD further states that the IRS recognizes the precedent this decision establishes for cases appealable to the Eighth Circuit and, therefore, will follow the decision for cases that have the exact facts within that circuit. However, the AOD also states that the IRS will continue to litigate its position that the decision is erroneous in cases having different facts in the Eighth Circuit and in all cases in other circuits. _____ indicates in the materials provided that he is not within the jurisdiction of the Eighth Circuit. We have enclosed a copy of this AOD that you can forward to him.

I hope this information is helpful. Please call _____ or me at _____ if you have any questions.

Sincerely,

Janine Cook
Branch Chief, Employment Tax 1
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures (2)