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

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Attachment 1

CC:TL-R-339-98
TEGE:EOEG:ET1:ERogers

ACTION ON DECISION

Subject: North Dakota State University v. United States,
84 F. Supp. 2d 1043 (D.N.D. 1999), *aff'd*, 255 F.3d 599 (8th Cir. 2001)

Issue:

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

Discussion:

North Dakota State University ("taxpayer") had an early retirement program that provided that tenured faculty members whose age and years of service totaled 70 (or 65 during some periods of time) might be eligible for a payment in return for retiring. Participation in the program was voluntary. Taxpayer and each prospective retiree negotiated the payment amount, which was capped at 100% of that employee's most recent annual salary. Various factors were considered in determining the retirement payment, including past performance, current salary, curriculum needs of taxpayer, and budget constraints. Under an Early Retirement Agreement, an employee agreed to give up tenure, contract, and/or other employment rights, agreed not to seek employment with a North Dakota public university or college, and agreed to give up any claim against taxpayer under the Age Discrimination in Employment Act.

The early retirement program was available to faculty who had received tenure. Tenure was granted to a faculty member upon recommendation by taxpayer to the North Dakota Board of Higher Education, which made the final tenure decision. Various factors were considered in making tenure decisions including scholarship in teaching, contribution to a discipline or profession through research, other scholarly or professional activities, and service to the institution and society.

Once tenure was granted, tenure gave the professor the right to continuous academic year employment. The annual tenure contracts were automatically renewed each year unless termination was permitted under tenure policies. Under the terms of the tenure program, which were non-negotiable, a tenured faculty member could be terminated based upon various fiscal reasons. Additionally, a tenured faculty member

could be dismissed for adequate cause. The tenure policies required that specific due process rights and procedures be afforded a tenured faculty member before any termination.

The Eighth Circuit held that a payment made to a tenured faculty member under the taxpayer'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 taxpayer. The court cited Rev. Rul. 58-301, 1958-1 C.B. 23, as support for its decision and rejected the government's argument that Rev. Rul 75-44, 1975-1 C.B. 15, should control the outcome of this case.

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 this ruling that the lump sum payment received by the worker was not wages for FICA and income tax withholding purposes.

In Rev. Rul 75-44, an employee had acquired both the rights to security in his employment and to additional pay or other recognition for longevity under a general contract of employment. The employer then paid a lump sum payment to the employee to enter into an agreement with the employer to perform a different type of work and to refrain from asserting employment rights that the employee had previously acquired. The IRS determined that the amount received by the employee was a lump sum settlement for the past performance of services reflected in the employment rights that the employee was giving up, and was money remuneration for services. The IRS concluded in this ruling that the lump sum payment was compensation for services under the Railroad Retirement Tax Act ("RRTA") and constituted wages for income tax withholding purposes.

We disagree with the court's analysis that tenure is not similar to the employment rights described in Rev. Rul 75-44. We also disagree with the court's analysis that this case is analogous to Rev. Rul. 58-301. The determination of whether early retirement payments made to tenured faculty members are subject to FICA taxes depends upon whether such payments arise out of the employer-employee relationship and not upon whether the payments are made to employees to relinquish a "contractual and constitutionally-protected right." In Social Security Board v. Nierotko, 327 U.S. 358 (1946), the Supreme Court stated that the term "wages" is to be broadly interpreted "to import the breadth of coverage" consistent with the purposes of the Social Security Act. Since no statutory exclusion from "wages" exists for early retirement payments made to employees or for payments made to employees for relinquishment of tenure rights, and because the payments in this case arise out of the employer-employee context for services rendered by the tenured faculty members for their employer, these payments should be considered wages subject to FICA taxes.

Therefore, we disagree with the court's reliance on Rev. Rul. 58-301 as support for its conclusion that payments to relinquish rights under this contract are not wages for FICA purposes. We continue to believe that the early retirement payments made to the tenured professors in this case are remuneration for services subject to FICA taxes because the payments arose out of the employer-employee relationship. These payments were received in recognition of the professors' agreements to relinquish their tenured rights that were acquired as a consequence of past services, similar to the amounts employees received in relinquishing their seniority rights acquired as a consequence of past services under Rev. Rul. 75-44

Recommendation:

Nonacquiescence.

Although we disagree with the decision of the court, we recognize the precedential effect of the decision to cases appealable to the Eighth Circuit, and therefore will follow it within that circuit only with respect to cases that have the exact facts as this case; that is, cases involving payments to college or university professors made in exchange for the relinquishment of their tenure rights. We will continue to litigate our position in cases having different facts in the Eighth Circuit, and in all cases in other circuits.

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