INTERNAL REVENUE SERVICE

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The Honorable [redacted]
United States Senate
Washington, D.C. 20510-1401

Dear Senator [redacted]:

I am responding to your letter to Commissioner Rossotti, dated September 22, 2000, on behalf of your constituent, [redacted] is a retired agent of the State Farm Insurance Companies (State Farm).

[redacted] asked whether the Internal Revenue Service (IRS) is correctly interpreting Jackson v. Commissioner, 108 T.C. 130 (1997) (enclosed). In Jackson the Tax Court held that termination payments to retired State Farm agents are not subject to tax under the Self-Employment Contributions Act (SECA). He believes that the IRS is applying the holding of that case incorrectly by denying retired State Farm agents capital gains tax treatment on their termination payments.

As background information on this issue, taxpayers won several cases dealing with the application of SECA tax to certain payments to retired insurance agents. Milligan v. Commissioner, 38 F.3d 1094 (9th Cir. 1994), rev'g T.C. Memo 1992-655; Gump v. U.S., 96-1 USTC (CCH) ¶ 50,312 (red. Cir. 1996), rev'g 96-1 USTC (CCH) ¶ 50,211 (Fed. Cl. 1955), and the Jackson case.

Effective for payments after December 31, 1997, Congress amended section 1402 of the Internal Revenue Code (the Code) to provide an exclusion from SECA tax for payments similar to those in the cases. Code section 1402(k).

The IRS follows Jackson and applies its holding to payments made before the effective date of section 1402(k) because that section codified the holding in Jackson. This policy is expressed in an action on decision, a published statement of IRS policy, CC-1997-012.

Jackson was a reviewed opinion, meaning that all the judges of the Tax Court agreed to the holding. The holding is stated in the final paragraph of the opinion, 108 T.C.

140.

> [W]e hold that the termination payments petitioner received in 1990 and 1991 are not subject to self-employment tax. Because we conclude that the termination payments were not "derived" from the carrying on of petitioner's insurance business, we need not decide the precise nature of the payments or specifically characterize them as a particular type of income. In other words, we need not decide in this case whether the termination payments are consideration for an agreement not to compete or the purchase of petitioner's agency, including its assets and goodwill.

The holding is expressed in the underlined sentence, stating that termination payments are not subject to SECA tax.[1] Section 1402(k), which enacted the holding in Jackson, also operates only to exclude termination payments from SECA tax.

I hope this information is helpful to your constituent. If you have any questions, please call me or Elizabeth Edwards of this office at (202) 622-6040.

Sincerely yours,

Jerry E. Holmes
Branch Chief, Employment Tax 2
Office of Division Counsel/
Assistant Chief Counsel
(Tax Exempt and Government Entities)

Enclosure (1)

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[1]Judge Parr wrote a concurring opinion, stating she concludes termination payments are "in the nature of a buyout." 108 T.C. 141. A concurrence is the opinion of only one judge. It does not represent the opinion of the Tax Court.