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

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The Honorable Herb Kohl
United States Senator
14 West Mifflin Street, Suite 300
Columbus, OH 43215

Attention:

Dear Senator Kohl:

This letter responds to your inquiry dated April 27, 2009, on behalf of one of your constituents who received a CP 2000 Notice for tax year 2006. Your constituent is a retired insurance agent who received payments from his former insurance company after he retired. The company classified these payments as non-employee compensation, but your constituent believes these payments are termination benefits that are not subject to self-employment tax.

During the 1990s, many retired insurance agents questioned the application of the self-employment tax to certain payments they received after retiring. The issue became rather controversial as agents filed several lawsuits in a number of jurisdictions and the courts decided some cases in favor of the taxpayer and others in favor of the government. As a result, the Congress recognized the need to clarify the law and effective for payments after December 31, 1997, the Congress amended section 1402 of the Internal Revenue Code to provide an exclusion from SECA tax for payments if they met certain requirements under new section 1402(k). These requirements are:

- The individual receives the amount after termination of his or her agreement to perform services for the company

- The individual performs no services for the company after termination

- The individual enters into a covenant not to compete against the company, which applies to at least the 1-year period beginning on the date of such termination, and

- The amount of the payment—
  -Depends primarily on policies sold by or credited to the account of the individual during the last year of his or her agreement or the extent to which such policies remain in force for some period after such termination, or both
  -Does not depend to any extent on length of service or overall earnings from services performed for the company (without regard to whether eligibility for payment depends on length of service)

Your constituent must satisfy all of these requirements to be able to exclude the payments he received from his former insurance company from self-employment tax. We do not know all the facts and circumstances surrounding the payments at issue, but it appears that under the Agent Termination Benefits Program form that you provided, the amount of the payment the former insurance company pays to a retired agent will increase based on the number of years of service. If the amount of the payment to a retired agent depends on the length of service, the payments will not satisfy the requirement in section 1402(k)(4)(B) for exclusion from net earnings from self-employment.

I hope this information is helpful. If you would like to discuss this further, please contact of my staff at or me at .

Sincerely,

Nancy J. Marks
Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)