pennsylvania
DEPARTMENT OF REVENUE

March 17, 2006
Pennsylvania Personal Income Tax
No. PIT-06-004
Insurance Company Agent's Agreement
Retirement and Pensions
Compensation
Termination Payments/Extended Termination Payments

ISSUES

(1) Whether the distribution of termination payments from Insurance Company to Taxpayer following Taxpayer's separation from service is subject to tax?

(2) Whether extended termination payments that will be paid beginning in the fifth year following Taxpayer's separation from service from Insurance Company are subject to tax as compensation?

CONCLUSIONS

(1) Because the Insurance Company Agent's Agreement provides for the distribution of termination payments for an aggregate period of 60 months either: (i) upon termination of the agreement two years or more after its effective date; or (ii) at any time after its effective date if the Taxpayer completed two or more continuous years of combined service, the monthly benefits are subject to tax.

(2) Because the provisions governing the extended termination payments meet the Pennsylvania definition of a commonly recognized old age or retirement benefit plan, these payments will not be subject to tax when paid following Taxpayer's retirement.

FACTS

The Insurance Company Agent's Agreement provides for two types of benefits: termination payments and extended termination payments.

Termination Payments.

In the event that the parties terminate the Agreement within two years of its effective date or the Taxpayer has two or more continuous years of combined service under either a prior Insurance Company Agent's Agreement or a Local Agent's Appointment and the Plan, Taxpayer is entitled to termination payments.

The benefits for the first 12 months following termination are calculated based on a percentage of service compensation on produced policies in the 12 months preceding termination. For each of the next succeeding 48 months following termination, Taxpayer will earn an amount equal to one-twelfth of the amount payable in the first 12 months after termination as based on the Plan.

The Insurance Company will pay benefits for a period of 60 months, and they are calculated in an amount equal to the same compensation for the second and subsequent policy years as would have been due and payable to Taxpayer for the first five years following the date of termination on all of the Insurance Company's policies personally written by Taxpayer.

Extended Termination Payments.

An individual is entitled to extended termination payments if: (i) the Agreement is terminated, and the Taxpayer qualified for the termination payments as set forth in the Agreement; (ii) Taxpayer is, at the time of termination, age 60 or older; (iii) had at least 20 years of service as an Insurance Company Agent and had 10 years of continuous service as an Insurance Company Agent immediately preceding the date the Agreement was terminated. The monthly payments begin on the last day of the 61st month following the date of termination and continue until Taxpayer's death.

The Insurance Company pays the monthly extended termination payments in an amount equal to that payable as termination payments.

The Insurance Company pays extended termination benefits in amounts equal to the monthly termination payments based on what is labeled "personal lines of insurance" classified by the Insurance Company in the schedule of payments and 50% of the portion of monthly payments provided for in the Agreement, based on commercial lines of insurance.

DISCUSSION

All amounts received under an employee deferred payment program are taxable in the year received to the extent that contributions and income earned on contributions were not taxed previously except:

(a) Payments from a qualifying retirement benefit program or old age benefit program paid to a retired employee by reason of his retirement;

(b) Payments paid to the estate or designated beneficiary of a participant by the reason of a participant's death;

(c) Payments received from a qualifying retirement benefit program or old age benefit program which are rolled over into another deferred payment program or IRA, where the transferred amounts are not includable in income for Federal Income Tax purposes; or

(d) Payments received at regularly recurring intervals during periods of disability by reason of disability.

Under Pennsylvania's Tax Reform Code of 1971, as amended, the term "compensation" does not mean or include ". . . payments commonly recognized as old age or retirement benefits paid to persons retired from service after reaching a specific age or after a stated period of employment . . ." 72 P.S. § 7301(d) (iii). For Pennsylvania Personal Income Tax purposes, a deferred payment program constitutes a qualifying retirement program or old age benefit program only if all of the following conditions are met:

(1) The Plan is reduced to writing and communicated to the participants;

(2) The Plan establishes eligibility requirements for separation from service by retirement on the basis of old age, infirmity, long-continued service or a combination of old age or infirmity and long-continued years of service;

(3) The Plan makes provisions for payments based on retirement to be made at regularly recurring intervals to employees after their separation from service by retirement which continue at least until the retired employee's death; and

(4) The Plan does not permit the distribution of program benefits to any employee until termination of employment except:

(A) Incidental disability benefits; or

(B) The return of the employee's previously taxed contributions and income or gains thereon, in the case of a contributory retirement benefit plan.

Other deferred payment programs constitute qualifying old age or retirement programs only if all of the following conditions are met:

(1) The Plan is reduced to writing and communicated to the participants; and

(2) Program benefits cannot be paid before retirement, death, disability, separation from service, unforeseeable emergency or the attainment of age 59 1/2, or, if payable before retirement, death, disability, separation from service, unforeseeable emergency or the attainment of age 59 1/2, program benefits are subject to substantial penalty when so paid; and

(3) The Plan makes provisions for payments to be made at regularly recurring intervals to participants which continue at least until the participant's death.

Here, the Plan is reduced to writing and an individual may not receive either termination payments or extended termination payments during Taxpayer's period of employment or service with the Insurance Company.

The Plan provides that the Agent's Agreement must have been terminated two years or more after its effective date or the individual must have completed at least two or more years of combined service at the time of termination as a prerequisite to receive the termination payments.[1] Although the termination payments are thus paid "after a stated period of employment" (two years), (72 P.S. § 7301(d)(iii)), the Plan provides an alternative means for the distribution of benefits upon termination that is not calculated with reference to a period of service and it limits the duration of the benefits to a period of five years.

The Commonwealth Court of Pennsylvania has held that a deferred payment program under which benefits can be received upon termination with the voluntary consent of the employer for a reason other than retirement are not commonly recognized old age or retirement benefits for Pennsylvania Personal Income Tax purposes. *Bickford v. Com.*, 533 A.2d 822 (Pa. Cmwlth. 1987).

Benefits paid to Taxpayer in the form of termination payments following retirement from service are subject to tax as compensation in the form of severance pay. Under this Plan, an individual can become an Insurance Company Agent and irrespective of age, qualify for the benefits upon terminating the Agreement at any time after two years of the Agreement's effective date or after completing two years of continuous service. Those qualifying for benefits receive them for a period of only five years. As the Taxpayer does not enjoy the rights of a pensioner by having the ability to take the benefits in the form of equal periodic payments for Taxpayer's life or life expectancy, they are taxable.

The extended termination payments that will be payable to Taxpayer following the receipt of the termination payments are payable only upon separation from service when, at the time of separation, Taxpayer is at least age 60 and rendered at least 20 years service (10 continuous) as an Insurance Company Agent. Because these provisions of the Plan meet Pennsylvania's definition of a commonly recognized old age or retirement benefit plan, the benefits will be excludable from compensation for Pennsylvania Personal Income Tax purposes.

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[1] As noted above, the termination payments are paid in monthly installments for a period of up to five years.