

Part III - Administrative, Procedural, and Miscellaneous

Proposed Revenue Procedure Regarding Services that Qualify For the Student FICA Exception

Notice 2004-12

I. Overview and Purpose

This notice contains a proposed revenue procedure providing a safe harbor that certain institutions of higher education, and certain affiliated organizations can use in applying the exception for services performed by a student provided under § 3121(b)(10) of the Internal Revenue Code (student FICA exception). A previous version of this safe harbor was issued in Rev. Proc. 98-16, 1998-1 C.B. 403. However, the Service has recently proposed amendments to the Employment Tax Regulations interpreting § 3121(b)(10) in order to clarify specific issues that have arisen with taxpayers and in litigation (see proposed regulations § 31.3121(b)(10)-2(c), (d), and (e) published in the Federal Register on February 25, 2004 (69 Fed. Reg. 8604)). In order to provide guidance that is consistent with the proposed regulations in all respects, the Service is suspending Rev. Proc. 98-16 and proposing to replace it with the revenue procedure contained in this notice.

The proposed revenue procedure updates the safe harbor of Rev. Proc. 98-16 in several respects that align it with the proposed regulations. First, the proposed revenue

procedure adds a primary function requirement to the definition of an institution of higher education. Section 3121(b)(10) applies only to services performed in the employ of a school, college or university, or an affiliated § 509(a)(3) organization. Under the proposed regulations and the new safe harbor, an organization can be a school, college or university only if its primary function is to conduct educational activities. Thus, in order to take advantage of the safe harbor in the revenue procedure, an institution must satisfy not only the Department of Education's regulations at 34 C.F.R. § 600.4 and satisfy the accreditation requirements of 34 C.F.R. § 600.2, as was required in Rev. Proc. 98-16, but also must have education and instruction as its primary function. The primary function requirement may make the exception under § 3121(b)(10) unavailable to certain institutions of higher education that are embedded within a larger organization like a hospital or museum.

Second, the proposed revenue procedure does not permit an institution to apply the student FICA exception to services performed by an employee who regularly works 40 or more hours per week. Under the existing regulations, services fall within the student FICA exception only if they are performed incident to and for the purpose of pursuing a course of study. The proposed regulations clarify that an individual who regularly works forty or more hours per week has the status of a career employee, and, accordingly, is not performing services incident to and for the purpose of pursuing a course of study. The proposed revenue procedure follows the proposed regulations. The student FICA exception generally, and the safe harbor provided by the proposed revenue procedure specifically, are still available for services performed by an

employee who on occasion works 40 or more hours per week and otherwise meets the requirements of the safe harbor.

Third, the proposed revenue procedure provides that an individual has career employee status if the individual is a “professional employee.” The proposed regulations provide that a professional employee for purposes of the student FICA exception is an employee whose primary duty consists of the performance of services requiring knowledge of an advanced type in a field of science or learning, whose work requires the consistent exercise of discretion and judgment in its performance, and whose work is predominantly intellectual and varied in character. The proposed revenue procedure follows the proposed regulations.

Fourth, the proposed revenue procedure expands the terms of employment that result in status as a career employee. Rev. Proc. 98-16 provided that an individual was to be considered a career employee if the employee was eligible to participate in one of several types of retirement plans, eligible for reduced tuition (with certain exceptions), or otherwise classified by the institution of higher education as a career employee. The proposed regulations adopt the same criteria for identifying individuals who have the status of a career employee and adds to the list eligibility for a number of other benefits. The proposed revenue procedure follows the proposed regulations, adding the additional criteria that cause an individual to have career employee status and fall outside the scope of the safe harbor. Employees considered as having the status of a career employee per se cannot have the status of a student for purposes of the student FICA exception.

Fifth, and finally, the proposed revenue procedure provides that an employee has career employee status if the individual is required to be licensed under state or local law in order to perform the services the individual provides to the school, college or university. The proposed revenue procedure follows the proposed regulation.

II. Request for Comments

Comments are requested on the proposed revenue procedure. Comments may be submitted on or before May 25, 2004, to Internal Revenue Service, PO Box 7604, Washington, DC 20044, Attn: CC:PA:LPD:PR (Notice 2004-12), Room 5203.

Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW., Washington, DC 20224, Attn: CC:PA:LPD:PR (Notice 2004-12), Room 5203. Submissions may also be sent electronically via the internet to the following email address:

Notice.comments@irs.counsel.treas.gov. Include the notice number (Notice 2004-12) in the subject line.

III. Effect on Other Documents

Rev. Proc. 98-16 is suspended effective February 25, 2004.

IV. Effective Date

The Service intends to issue a final revenue procedure at the same time that the proposed regulations under § 3121(b)(10) are finalized. Until a final version of the proposed revenue procedure is issued, taxpayers may rely on the proposed revenue procedure with respect to services performed on or after February 25, 2004 (the date

prop. Reg. § 31.3121(b)(10)-2(c) - (f) (69 FR 8604) was published in the Federal Register).

V. Proposed Revenue Procedure

SECTION 1. PURPOSE

This revenue procedure sets forth generally applicable standards for determining whether service in the employ of certain public or private nonprofit schools, colleges, universities, or affiliated organizations described in § 509(a)(3) of the Internal Revenue Code (the Code) performed by a student qualifies for the exception from Federal Insurance Contributions Act (FICA) tax provided under § 3121(b)(10) of the Code (Student FICA exception). These standards are intended to provide objective and administrable guidelines for determining employment tax liability.

SECTION 2. SCOPE

.01 Institutions of higher education typically distinguish between career employees and student employees. Sections 5 and 6 of this revenue procedure contain generally applicable standards for determining whether or not services performed by employees of certain institutions of higher education are eligible for the Student FICA exception.

.02 The standards contained in this revenue procedure do not apply to employees who are postdoctoral students, postdoctoral fellows, medical residents, or medical interns because the services performed by these employees cannot be assumed to be incident to and for the purpose of pursuing a course of study. The employment activities of these individuals overlaps with the activities comprising the course of study, and thus it is not appropriate to apply the standards of this revenue procedure to these individuals.

.03 The standards contained in this revenue procedure may not constitute the exclusive method for determining whether the Student FICA exception applies. If the standard for qualifying for the exclusion described in section 6 of this revenue procedure (providing generally that an employee enrolled at least half-time at an institution of higher education has the status of student) is not met, whether or not service in the employ of a school, college, university, or affiliated organization described in § 509(a)(3) of the Code will qualify for the Student FICA exception will depend on consideration of all the facts and circumstances.

SECTION 3. BACKGROUND

.01 Sections 3101 and 3111 of the Code impose social security and Medicare taxes (FICA taxes) on employees and employers, respectively, equal to a percentage of the wages received by an individual with respect to employment.

.02 Section 3121(a) of the Code defines "wages" for purposes of FICA taxes as all remuneration for employment, with certain exceptions. Section 3121(b) of the Code defines "employment" as services performed by an employee for an employer, with certain exceptions.

.03 Section 3121(b)(10) of the Code excepts from the definition of employment services performed in the employ of a school, college, or university (whether or not that organization is exempt from income tax), or an affiliated organization described in § 509(a)(3) of the Code, if the services are performed by a student who is enrolled and regularly attending classes at that school, college or university. Remuneration for services excluded from the definition of employment under § 3121(b)(10) of the Code is

not subject to FICA taxes.

.04 Section 31.3121(b)(10)-2 of the Employment Tax Regulations provides that whether an employee has the status of a student is determined on the basis of the employee's relationship with the school, college, or university for which the services are being performed. An employee who performs services in the employ of a school, college, or university as an incident to and for the purpose of pursuing a course of study at the school, college, or university has the status of a student in the performance of those services. Services that are not incident to and for the purpose of pursuing a course of study do not qualify for the exception. If the employee performs services as an incident to and for the purpose of pursuing a course of study and, therefore, has the status of a student, the amount of remuneration for services performed by the employee, the type of services performed by the employee, and the place where the services are performed are immaterial for purposes of the Student FICA exception.

.05 Section 218 of the Social Security Act (the Act), 42 U.S.C. section 418, allows states to provide Social Security coverage for services performed by students for the public school the student is attending under agreements established with the Social Security Administration. If a state has exercised its option under § 218 of the Act to provide for coverage of student services, § 3121(b)(10) of the Code provides that those services will not qualify for the Student FICA exception.

SECTION 4. CERTAIN INSTITUTIONS OF HIGHER EDUCATION

.01 The standards contained in this revenue procedure apply to “institutions of higher

education” meeting the requirements of § 31.3121(b)(10)-2(c) of the proposed Employment Tax Regulations. For purposes of this revenue procedure, the term “institution of higher education” includes any public or private nonprofit school, college, university within the meaning of prop. Reg. § 31.3121(b)(10)-2(c), or affiliated organization described in § 509(a)(3) of the Code, that meets the requirements set forth in Department of Education regulations at 34 C.F.R. § 600.4, as amended from time to time, and that is accredited or preaccredited by a nationally recognized accrediting agency as defined in the Department of Education regulations at 34 C.F.R. § 600.2.

.02 Services for other institutions may also be eligible for the Student FICA exception. Thus, for example, services performed by a student for a secondary school may be eligible for the Student FICA exception. Whether or not services for other institutions, such as secondary schools, qualify for the Student FICA exception is determined based on the facts and circumstances of each case.

SECTION 5. STUDENT FICA EXCEPTION NOT AVAILABLE FOR EMPLOYEES WITH CAREER EMPLOYEE STATUS

.01 Services performed by individuals with career employee status are not eligible for the Student FICA exception under the standard in section 6 of this revenue procedure because their services are not incident to and for the purpose of pursuing a course of study. See prop. Reg. § 31.3121(b)(10)-2(d)(3)(ii).

.02 Career employee status. Services of an employee with career employee status are not incident to and for the purpose of pursuing a course of study. An employee may be considered to have career employee status based on the employee’s hours worked,

whether the employee is a “professional employee,” the employee’s terms of employment, or whether the employee is licensed under state or local law to work in the field in which the employee performs services. These standards are set forth in prop. Reg. § 31.3121(b)(10)-2(d)(3)(ii). An employee has career employee status if the employee is described in paragraph (1), (2), (3), or (4) of this section.

(1) Hours worked. An employee has the status of a career employee if the employee regularly performs services 40 hours or more per week.

(2) Professional employee. An employee has the status of a career employee if the employee is a professional employee. A professional employee is an employee--

(a) Whose primary duty consists of the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study, as distinguished from a general academic education, from an apprenticeship, and from training in the performance of routine mental, manual, or physical processes.

(b) Whose work requires the consistent exercise of discretion and judgment in its performance; and

(c) Whose work is predominantly intellectual and varied in character (as opposed to routine mental, manual, mechanical, or physical work) and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

(3) Terms of employment. An employee’s terms of employment may indicate that the employee has career employee status. An employee with career employee status

includes any employee who is--

- (a) Eligible to receive vacation, sick leave, or paid holiday benefits;
- (b) Eligible to participate in any retirement plan described in § 401(a) of the Code that is established or maintained by the employer; or would be eligible to participate if age and service requirements were met;
- (c) Eligible to participate in an arrangement described in § 403(b) of the Code, or would be eligible to participate if age and service requirements were met;
- (d) Eligible to participate in a plan described under § 457(a), or would be eligible to participate if age and service requirements were met;
- (e) Eligible for reduced tuition (other than qualified tuition reduction under § 117(d)(5) of the Code provided to a teaching or research assistant who is a graduate student) because of the individual's employment relationship with the institution;
- (f) Eligible to receive employee benefits described under § 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), or 137 (adoption assistance); or
- (g) Classified by the employer as a career employee.

(4) Licensure. An employee is a career employee if the employee is required to be licensed under state or local law to work in the field in which the employee performs services.

.03 If an individual performs services in multiple job positions, the individual will be deemed to have career employee status with respect to all of the positions if the individual has career employee status in any one or more of the job positions.

SECTION 6. STANDARDS APPLICABLE TO UNDERGRADUATE AND GRADUATE STUDENTS

.01 An individual who is a half-time undergraduate student or a half-time graduate or professional student and who does not have the status of a career employee will qualify for the Student FICA exception under this revenue procedure with respect to services performed at or for an institution of higher education described in section 4 of this revenue procedure in which they are enrolled or at affiliated organizations described in § 509(a)(3) of the Code. Services performed by a student for any other employer are not covered by the standards of this revenue procedure.

.02 An individual is deemed to be a half-time undergraduate or half-time graduate or professional student if the individual does not have the status of a career employee status and is an undergraduate or graduate student who is in the last semester, trimester, or quarter of a course of study requiring at least two semesters, trimesters, or quarters to complete and is enrolled in the number of credit or unit hours needed to complete the requirements for obtaining a degree, certificate, or other recognized educational credential offered by that institution of higher education even if enrolled in less than half the number required of full-time students.

.03 The determination of student status should be made at the end of the drop-add period and may be adjusted thereafter at the institution of higher education's option. The determination of student status for payroll periods ending before the end of the drop-add period may be based on the number of semester, trimester, or quarter hours being taken at the end of the registration period for that semester, trimester, or quarter.

.04 If an individual is described in section 6.01 or 6.02 of this revenue procedure, services performed by the individual are eligible for the Student FICA exception with respect to all services performed during all payroll periods of a month or less that fall wholly or partially within the academic term.

.05 The Student FICA exception does not apply to services performed by an individual who is not enrolled in classes during school breaks of more than five weeks (including summer breaks of more than five weeks), other than services described in section 6.04. See Rev. Rul. 72-142, 1972-1 C.B. 317, and Rev. Rul. 74-109, 1974-1 C.B. 288.

However, the Student FICA exception applies to employment which continues during normal school breaks of 5 weeks or less during which the individual is not eligible for the Student FICA exception pursuant to section 6.01 of this revenue procedure provided that the individual qualifies for the Student FICA exception pursuant to section 6.01 of this revenue procedure on the last day of classes or examinations preceding the break and is eligible to enroll in classes for the first academic period following the break.

.06 If the standards of this revenue procedure are met (and section 8 does not apply), the amount of remuneration for services performed by the employee, the type of services performed by the employee, and the place where the services are performed are immaterial. If the services performed by a student otherwise described in section 6.01 or 6.02 are covered under an agreement pursuant to section 218 of the Act, the Student FICA exception does not apply.

.07 For provisions relating to domestic service performed by a student in a local college club, or local chapter of a college fraternity or sorority, see § 31.3121(b)(2)-1.

SECTION 7. DEFINITIONS

For purposes of the standard contained in section 6 of this revenue procedure, the following definitions must be used. For purposes of the following definitions, the term "institution of higher education" means an institution of higher education as defined in section 4 of this revenue procedure.

.01 Undergraduate student. The term "undergraduate student" has the meaning attributed to that term in the Department of Education regulations at 34 C.F.R. section 674.2.

.02 Half-time undergraduate student. The term "half-time undergraduate student" has the meaning attributed to that term in the Department of Education regulations at 34 C.F.R. section 674.2.

.03 Graduate or professional student. The term "graduate or professional student" means a student who--

(1) is enrolled at an institution of higher education for the purpose of obtaining a degree, certificate, or other recognized educational credential above the baccalaureate level or is enrolled in a program leading to a professional degree;

(2) has completed the equivalent of at least three years of full-time study at an institution of higher education, either prior to entrance into the program or as part of the program itself; and

(3) is not a postdoctoral student, postdoctoral fellow, medical resident, or medical intern.

.04 Half-time graduate or professional student. The term "half-time graduate or

professional student" means an enrolled graduate or professional student, as defined in section 7.03 of this revenue procedure, who is carrying at least a half-time academic workload at an institution of higher education as determined by that institution according to its own standards and practices.

SECTION 8. ANTI-ABUSE RULE

The standards in this revenue procedure must be applied in a reasonable manner, consistent with the purpose of excluding from employment only services that are performed as an incident to and for the purpose of pursuing a course of study at an institution of higher education as defined in section 4 of this revenue procedure. If the standards are inappropriately applied in a manner that conflicts with this underlying purpose so as to manipulate or mischaracterize the nature of the relationship between an employee and an institution of higher education, resulting in the improper avoidance of payment of FICA taxes, then whether the Student FICA exception applies will be determined on the basis of all the facts and circumstances, rather than on the basis of the specific standards set forth in section 6 of this revenue procedure. For example, the standards would be inappropriately applied through the manipulation of the relationship between employees and the institution of higher education if a university claimed that the Student FICA exception applied to research laboratory workers, who had been career employees, but were converted to non-career status and required to enroll in a certificate program granting six credit hours per semester for work experience in the laboratory. As another example, if an individual who was not a student worked for a university on a full-time basis for many years, in a job generally performed by non-

students (but nonetheless failed to meet the literal definition of career employee), and then enrolled at the university for six credit hours of course work per semester while continuing the full-time work in the same job, it may not be appropriate to apply the standards of this revenue procedure to conclude that the individual's work has become incident to and for the purpose of pursuing a course of study solely because the individual enrolled for this course work. In both of these examples, whether the work is performed incident to and for the purpose of pursuing a course of study must be determined on the basis of all the relevant facts and circumstances.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for services performed on or after February 25, 2004 (the date prop. Reg. § 31.3121(b)(10)-2(c) - (f) (69 FR 8604) was published in the Federal Register).

The principal author of this notice is Stephen D. Suetterlein of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). However, other personnel from the Service and Treasury Department participated in the development of this notice. For further information regarding this notice contact Mr. Suetterlein at (202) 622-6040 (not a toll-free call).