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MEMORANDUM FOR STEVEN T. MILLER
DIRECTOR (T:EO)

FROM: Mary Oppenheimer
Assistant Chief Counsel (CC:EBEO)

SUBJECT: Medical Resident FICA Refund Claims

You have been contacted by field offices about various Federal Insurance Contributions Act ("FICA") refund claims that have been filed around the country. You in turn contacted this office for advice. Because this advice will be distributed to the field offices, it constitutes conduit Chief Counsel Advice subject to disclosure under § 6110 of the Internal Revenue Code.

The purpose of this memo is to provide our analysis of how TE/GE and IRS Exam personnel should approach the legal issues involved in FICA refund claims filed with respect to medical residents. This memo begins with a general description of medical residency programs and the student FICA exception.[1] This memo next explains that whether the student FICA exception applies, or whether a resident is a student within the meaning of the student exclusion under the Social Security Act (the "Act"), is determined with reference to the common law employer. In this regard, this memo discusses many of the relevant facts in identifying the common law employer. Next, this memo discusses the special considerations if the employer is a state or local government entity, including determining whether the residents' services are covered under an agreement with the Social Security Administration (SSA) to cover state and local government employees under social security (a "§ 218 agreement"). If residents' services performed for a state or local government entity are not covered under a state's § 218 agreement, or if the common law employer is a nongovernmental employer, then it must be determined whether the requirements under § 3121(b)(10) ("the student FICA exception") have been met, including the employer status and student status requirements. Finally, the memo discusses the refund claim procedural requirements that an employer

[1]FICA refund claims have been filed also with respect to residents in other health care fields, such as dentistry. The same legal analysis applies in those cases as in medical resident cases.

must meet in order to receive a refund of employment taxes. See Exhibit 1 for a Student FICA exception analysis flow-chart.

Medical Residency Programs[2]

A medical residency program prepares a medical doctor (that is, a person who has graduated from medical school and earned a medical degree) for practice in a medical specialty. The medical doctors in a residency program are referred to as "residents."[3] Most residents are in residency programs accredited either by the Accreditation Council for Graduate Medical Education (ACGME) or the American Osteopathic Association (AOA). These accrediting bodies require that a sponsoring institution abide by detailed program requirements covering all aspects of the training program. The largest number of residency programs are in the areas are family practice, internal medicine, pediatrics, obstetrics/gynecology, radiology, and general surgery. The program requirements vary depending upon the type of program.[4] In completing an accredited program, a resident typically completes the education requirements for certification by a specialty board recognized by the American Board of Medical Specialties (ABMS). The resident is then eligible to take the board examination in a medical specialty area.[5]

To become a resident, an individual must have graduated from medical school and have passed parts one and two of the U.S. medical licensing exam. The individual is then eligible to receive a temporary license from the appropriate state medical licensing board. The temporary license permits the resident to practice under the auspices of the residency program in which the resident participates. After completing a period of graduate medical education (GME)

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[2]The description of medical residency programs in this memo is based largely upon information in the American Medical Association's, Graduate Medical Education Directory (2000/2001) (commonly referred to as the "Green Book").

[3]The term "intern" historically referred to an individual participating in a one-year training program that was a prerequisite to admission into a residency program. Internship programs were discontinued across the country in 1975, and residency programs have since included medical school graduates in their first year of graduate medical education. First year residents are often referred to as interns. Residents may also be referred to as "house staff" or "house officers."

[4]The program requirements for ACGME accredited programs are set forth in the Green Book. For example, the program requirements for family practice and internal medicine are set forth starting on pages 78 and 93 respectively.

[5]Being eligible to take a board examination or having passed a board examination is often a prerequisite to obtaining staff privileges or participating as a provider in health insurance plans.

(typically one year, as determined by the state[6]) and passing part three of the U.S. medical licensing exam, a resident is eligible to become fully licensed to practice medicine. At this point, the resident can legally practice outside the residency program, either by leaving the residency program, or by "moonlighting" while still in the residency program.

GME programs have a "sponsoring institution" and may have other "participating institutions."[7] An "institution" is an organization having the primary purpose of providing education or health care services (e.g., a medical school or a hospital).[8] The sponsoring institution is usually a medical school or a hospital. A hospital that is a sponsoring institution will often have some affiliation with a medical school. The sponsoring institution establishes the residency program and has overall authority and is responsible for the residents' GME. A sponsoring institution generally sponsors residency programs in several specialty areas. The participating institutions provide additional opportunities to obtain medical experiences within a residency program. Both sponsoring and participating hospitals are commonly referred to as "teaching hospitals." Although the organization structure of GME programs vary, see Exhibit 2 for models of common structures.

Most training programs require periods of residency of from three to seven years depending upon the specialty area.[9] The duties and responsibilities of a medical resident may change as the training program progresses. Residents take on more responsibility according to their level of education, ability and experience, including supervising the work of more junior residents along with attending physicians.

Residents are supervised by "attending physicians." Attending physicians generally play two roles with respect to medical residents. First, attending physicians are responsible for patient care services. An attending physician must

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[6]Nevada requires three years of GME; Connecticut, Michigan, New Hampshire, New Mexico, Pennsylvania, South Dakota, Utah and Washington require two years.

[7]The terms "sponsoring institution" and "participating institution" are used by the American Medical Association's Green Book.

[8]For purposes of this memo, the term "hospital" means any facility that has as its purpose the provision of medical care to patients, including outpatient medical clinics that provide outpatient services.

[9]For example, family practice and internal medicine typically require a 3 year training period, whereas general surgery typically requires a 5 year training program which may be extended by one or two years if the resident participates in a subspecialty program. See Green Book, pages 78, 93, 339, 344.

be the physician of record for every patient. In this regard, the attending physician may be acting as an agent of the hospital with respect to patient care services depending upon the attending physician's relationship with the hospital. The relationship with the hospital may be either as an employee or independent contractor. The attending physician may be paid by the hospital or may merely have staff privileges at the hospital.

Second, attending physicians also have a duty to the sponsoring institution to train medical residents and monitor their progress. Regardless of whether the sponsoring institution is a medical school or hospital, attending physicians generally hold faculty appointments at the sponsoring institution and are referred to as "faculty," even though they may or may not be part of the regular faculty of the medical school. Attending physicians may or may not be compensated by a sponsoring institution for services performed in training residents.

The entity responsible for providing patient care services could also be a faculty practice plan affiliated with a university medical school. Medical school faculty, as part of their duties as medical school professors, may treat patients at hospitals affiliated with the medical school under the auspices of a faculty practice plan. Faculty practice plans may or may not be legal entities apart from the medical schools with which they are affiliated. The patient care fees generated by faculty practice plans accrue to the affiliated medical school. Medical residents are often involved in patient care services provided by faculty practice plans.

The Student FICA Exception Under § 3121(b)(10)

Sections 3101-3126 of the Internal Revenue Code impose Federal Insurance Contribution Act (FICA) taxes on the wages of employees. FICA taxes consist of an old-age, survivors, and disability insurance portion (usually called social security tax) and a Medicare portion.

Section 3121(b)(10) of the Code excepts from the definition of employment for FICA purposes services performed in the employ of a school, college, or university ("S/C/U") (whether or not that organization is exempt from income tax), or an affiliated organization that satisfies section 509(a)(3) of the Code in relation to the S/C/U ("related § 509(a)(3) organization") if the service is performed by a student who is enrolled and regularly attending classes at that S/C/U. Thus, the student FICA exception applies to services only if both the "employer status" and "student status" requirements are met.

The employer status requirement means that the employer for whom the employee performs services (the common law employer) must be either a S/C/U or a related § 509(a)(3) organization. The student status requirement means that the employee must have the status of a student at the S/C/U. If either the student

status or employer status requirement is not met, the student FICA exception does not apply, and the resident would be covered under the FICA unless the resident's services qualify for some other exception.[10]

Determining the Common Law Employer

The first step in determining whether a medical resident is subject to FICA is to determine the entity that is the common law employer of the resident. Section 31.3121(b)(10)-2(c) of the Employment Tax Regulations provides that "the status of the employee as a student performing the services shall be determined on the basis of the relationship of such employee with the organization for which the services are performed." Thus, the identity of the common law employer is essential to determining whether the exclusion under § 3121(b)(10) applies because the common law employer must be a S/C/U. Identifying the common law employer is also essential to determining whether the resident is covered by a § 218 agreement (discussed below).

This issue arises because the residency program may include assignments ("rotations") at institutions other than the sponsoring institution. For example, the sponsoring institution may be a medical school but all clinical aspects of the residency may be performed at participating institutions whose only affiliation with the medical school is by contract ("affiliation agreement") (see Exhibit 2, Model C). The sponsoring institution may assert that the participating hospital where the services are performed is not the common law employer. Thus, the issue arises whether the sponsoring institution or the hospital where the resident performs services is the resident's common law employer.[11]

The common law employer is the party that has the right to direct and control the medical resident. Direction and control is the test not just for determining whether the worker is an employee versus independent contractor, but also determines which party is the employer when the worker has a relationship with more than one entity. See the training materials that you received on employee versus independent contractor status. "Independent Contractor or Employee?" Training 3320-102 (Rev. 10-96) TPDS 84238I.

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[10]For example, if the employer is a state or local government, the resident's services are not covered under a § 218 agreement, and the resident is a participant in a retirement system under section 3121(b)(7)(F), the resident's services would not be considered employment for FICA purposes. Section 3121(b)(7)(F) became effective with respect to services performed after July 1, 1991. However, the resident's services would probably be subject to Medicare tax under § 3121(u)(2).

[11]The institutions filing refund claims do not assert that the medical residents were independent contractors.

Section 3121(d)(2) of the Code provides that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The question of whether an individual is an employee under the common law rules or an independent contractor is one of fact to be determined after consideration of the facts and the application of the law and regulations in a particular case. Guides for determining the existence of that status are found in three substantially similar sections of the Employment Tax Regulations; namely, sections 31.3121(d)-1, 31.3306(i)-1 and 31.3401(c)-1 relating to the FICA, the Federal Unemployment Tax Act (FUTA), and federal income tax withholding, respectively.

In describing when an employment relationship exists, § 31.3121(d)-1(c)(2) of the regulations provides that

> "[g]enerally, such relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but as to how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he or she has the right to do so."

The regulations generally identifying employers speak of them as persons who employ employees (§§ 31.3121(d)-2 and 31.3306(a)-1 of the regulations) and as any person for whom services are performed as an employee (§ 31.3401(d)-1 of the regulations).

The Entity Which Pays the Resident is Not Automatically the Employer

The fact that the sponsoring institution pays the resident and treats the resident as an employee for payroll purposes does not mean that the resident is the common law employee of the sponsoring institution. The sponsoring institution could instead be the statutory employer (the person having control over the payment of wages) under § 3401(d)(1).[12] Alternatively, the sponsoring institution may be an agent for purposes of employment tax obligations under § 3504, may be a common paymaster under § 3121(s), or may merely be acting as a common law agent for payroll purposes. Although a statutory employer, agent, or common

[12]Section 3401(d)(1) defines the term "employer" for purposes of income tax withholding. This section has been made applicable for FICA purposes under Otte v. United States, 419 U.S. 43 (1974) and later cases.

paymaster (but not a common law agent) is liable for any FICA tax due, whether the student FICA exclusion applies is determined with reference to the common law employer.

Authorities Involving Three-Party Relationships

Several cases involving three-party employment arrangements have considered which entity, if any, is the common law employer. In Professional & Executive Leasing, Inc. v. Commissioner 89 T.C. 225, 232-233 (1987), aff'd, 862 F.2d 751 (9th Cir. 1988) ("PEL"), PEL furnished workers to client businesses and treated the workers as its employees. PEL covered the workers in pension, profit-sharing, and fringe benefit plans. PEL also issued paychecks to the workers, paid the related federal and state employment taxes, and provided workmen's compensation coverage. PEL received a fee for each worker provided to the client. By contract PEL had the right to terminate or reassign a worker. The workers generally had a preexisting employment and ownership relationship with the clients for whom they worked. PEL reviewed the workers' qualifications only for the proper professional licenses. The client businesses provided equipment, tools and office space for the workers. In appropriate cases, the client was required to provide malpractice insurance naming PEL as an insured.

Among the factors considered by the courts in PEL were the degree of control over the details of the work; investment in the work facilities; withholding of taxes, workmen's compensation and unemployment insurance funds; right to discharge; permanency of the relationship; and the relationship the parties think they are creating. Citing Bartels v. Birmingham, 332 U.S. 126 (1947), the Tax Court noted that a contract purporting to create an employer-employee relationship will not control where the common law factors (as applied to the facts and circumstances) establish that the relationship does not exist.

The court found that an employment relationship did not exist between PEL and the workers because PEL exercised minimal, if any, control over the workers; rather, each client and the worker controlled the details of the work and the selection of assignments. PEL did not have a genuine right to terminate or reassign the workers. In addition, PEL had no investment in the work facilities; the clients provided office space, tools and equipment. Despite the contract terms giving PEL control over the workers and labeling the relationship between PEL and the workers as employment, the court found that PEL merely performed a payroll and bookkeeping function. The court held that the workers were not employees of PEL, but of the clients.

In Burnetta v. Commissioner, 68 T.C. 387 (1977), a company was formed to do the selection, hiring, training and instruction of workers who would then be contracted out to client businesses, such as Burnetta's. However, in actual

practice, the clients did the screening and selection of workers. The client also had the right to discharge a worker and determined the workers' pay. The worker completed time sheets, which the client approved and submitted to the company. The company prepared the workers' paychecks, deducting applicable employment taxes, and mailed them to the clients to give to the workers. The company billed the client monthly and sometimes paid the workers before being paid by the client. The company received a fee based on a percentage of the workers' gross compensation.

The court held that the workers were employees of the clients, not of the company. The court found that the company essentially provided payroll and recordkeeping services for the clients. "In short, Staff simply relieved its business clients (including the petitioner corporations) of the burden of providing their payroll and recordkeeping functions and did not have the right to control its clients' employees in the manner normally associated with and contemplated by the typical common law employer-employee relationship."[13] It was the client, not the company, that interviewed and hired the workers, determined their salaries, and fired them if dissatisfied with their work. The court noted also that the right to control the workers as to the result to be accomplished by their work and the details and means by which the result was accomplished rested with the clients. The company never provided job-related instructions to the workers or had substantial contact with the workers during their employment.

In re Critical Care Support Services, Inc., 138 B.R. 378 (E.D.N.Y. 1992), involved an agency that provided critical care nurses to hospitals. The agency screened the nurses for their qualifications, including licenses, skills and insurance. The agency determined whether to send a nurse to any hospital and also determined the hospitals, duties and shifts to which the nurse was assigned. The agency paid the nurses and billed the hospitals for the nursing services. If a hospital was dissatisfied with a nurse's performance, it notified the agency not to send the nurse again. The agency then decided whether to send the nurse on future assignments to other hospitals.

The agency argued that it was not the employer of the nurses because the agency did not actually control the nurses in their performance of services at hospitals; rather the nurses were controlled by the hospital. The court observed that it is difficult to demonstrate the existence of a right to control without evidence of actual exercise of the right. The court noted, however, that the professional critical care nurses, who were carefully screened by the agency, did not have to be actually controlled in their every movement by the agency. The agency retained the right to control the nurses as reflected in its right to assign them to any hospitals (or

[13]68 T.C. at 391 and 399.

none at all) or duties, specifying the time and place of the work. The agency also paid the nurses directly, regardless of whether receiving payment from the hospitals. The court held that the nurses were employees of the agency.

In Hospital Resource Personnel, Inc. v. United States, 68 F.3d 421 (11th Cir. 1995), another case involving a nurse staffing agency, in addition to considering whether the taxpayer was entitled to relief under section 530 of the Revenue Act of 1978, the court considered whether the staffing agency was the common law employer of the nurses. In concluding that the agency was not the common law employer, the court found persuasive the facts that the agency did not instruct or train the nurses; it did not mandate full-time employment; it was the nurses themselves who provided transportation, incidental expenses, uniforms, tools, and materials; and, in contrast to Critical Care Support Services, supra, it neither scheduled the tasks nor set the number of hours the nurses must have worked. In addition, the nurses did not work on the agency's premises, and they were free to provide their services directly to hospitals and to register with other similar nursing agencies.

In Revenue Ruling 57-21, 1957-1 C.B. 317, the IRS considered whether a licensed physician in residency at a hospital was an employee of an organization for which the physician worked on a part-time basis as part of the physician's clinical training. Under the facts of the ruling, the physician's services were made available to the organization for four hours per week under special arrangements with the hospital. As staff physician for the organization, the physician prescribed medication and recommended treatment for the organization's handicapped workers. The physician directed the nurse in her duties and suggested phases of development for the medical program. The resident did not carry on a private practice. The IRS concluded that the physician was an employee of the organization.[14]

The Dual Functions of GME Programs

Determining which institution is the common law employer is complicated by the dual functions that GME programs have. While the primary purpose of GME programs is to train medical doctors in a medical specialty, they also provide residents who perform patient care services. Although it is clear that the sponsoring institution is responsible for resident training, the question arises as to which entity has the right to direct and control the resident's performance of patient care services. The fact that the sponsoring institution evaluates the resident's

[14] See also Rev. Rul. 55-500, 1955-2 C.B. 398 (IRS held that students assigned to a manufacturing corporation by their college pursuant to an agreement between the college and the manufacturing corporation were employees of the corporation for employment tax purposes).

training progress does not necessarily mean that it has the right to direct and control the resident's patient care services. In State of Minnesota v. Apfel, 151 F.3d 742 (8th Cir. 1998), discussed below, the status of the medical school as the employer appears not to have been questioned, so it was not considered or addressed by the court.[15] The case therefore is not legal authority for the proposition that the medical school is the common law employer of medical residents who perform services at a hospital that is not part of the medical school or its university.

Liability in Tort for Resident Negligence

In analyzing which entity has the right to direct and control residents in performing patient care services, it is instructive to consider which entity may be liable for the negligent act of a resident based upon the application of common law agency principles because these same principles determine whether a common law employment relationship exists.[16] If liability is not determined by the affiliation agreement, liability would be based upon application of agency principles, including the doctrine of respondeat superior.

Under the doctrine of respondeat superior, the common law employer is liable in tort for the negligent act of its employee so long as the employee is acting within the scope of employment.[17] One writer has suggested that most courts would find that the hospital where services are performed is the "general employer" of the resident and thus would be liable for the resident's negligence based upon respondeat superior.[18]

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[15]State of Minnesota involved liability under Minnesota's § 218 agreement, which covered employees of the University of Minnesota. Nothing in the opinion suggests that either side ever questioned whether the University was the employer. In fact, the Government's case was based on coverage of University employees under Minnesota's § 218 agreement. The court opinion does not mention whether the residents were performing services at University facilities or elsewhere. The opinion assumes that the residents were common law employees of the University, but concluded they were not "employees" within the meaning of the section 218 agreement.

[16]Of course, residents may held liable for their own negligent act, but plaintiffs will usually seek to hold another party vicariously liable.

[17]Restatement (Second) of Agency § 243 (1958).

[18]Stewart R. Reuter, M.D., J.D., Professional Liability in Postgraduate Medical Education, Who is Liable for Resident Negligence?, 15 J. L. Medicine 485, 503-04 (1994) ("The second question [(after examining the affiliation agreement)] is whether the resident is an employee of the hospital. Most courts would answer yes.") citing, for example, Newton County Hospital v. Nickolson, 207 S.E.2d 659 (Ga. App. 1974) ("[W]hen a person is taken directly to a hospital as where he is rendered unconscious in an accident, and a physician hired by the hospital, such as an intern or resident, is guilty of malpractice . . .

However, the writer also suggests that alternative liability may rest the attending physician or medical school based upon other agency theories. For example, the attending physician may be liable as a "borrowing employer" based upon the borrowed servant doctrine. Under this theory, the hospital remains the general employer, but if the attending physician exercises sufficient control with respect to a particular act, the attending physician may be considered the borrowing employer."[19] In addition, the writer suggests that the attending physician or medical school faculty member may be liable along with the hospital under the joint employment theory. Under this theory, alternative liability may be based upon the fact that the attending physician or faculty member has a strong right to control the conduct of a resident who cares for the physician's patient.[20]

Which Entity Benefits Economically From Resident Services?

It is also instructive to consider for whose benefit (other than the patient) the resident's services are being performed. In this regard, it is instructive to consider which entity benefits economically from resident services; in other words, who receives payment for resident services? It is our understanding that a hospital does not bill directly for resident services. Instead, as in the case of nursing services, charges for resident services are subsumed within the overall amount billed to a patient receiving care at the hospital. In addition, Medicare subsidizes teaching hospitals for their GME costs, but Medicare does not subsidize medical schools for their GME costs.[21] Thus, the hospital benefits economically from resident patient

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a different situation arises. Such physician usually stands in a position with the hospital, which, under the normal tests of the existence of a master-servant relationship, would call for a ruling that he was the hospital's servant.").

[19]Id. at 504-07; Restatement (Second) of Agency § 227(1958) provides that "[a] servant directed or permitted by his master to perform services for another may become the servant of such other in performing the services. He may become the other's servant as to some acts and not as to others." Comment b. provides that "[i]n the absence of evidence to the contrary, there is an inference that the actor remains in his general employment so long as, by the service rendered another, he is performing the business entrusted to him by the general employer. There is no inference that because the general employer has permitted a division of control, he has surrendered it".

[20]Id. at 507-09; The Restatement (Second) of Agency § 226 (1958) provides that "a person may be the servant of two masters, not joint employers, at one time and as to one act, if the service to one does not involve abandonment of the service to the other." Under comment b., joint employment occurs when two employers agree to share the services of an employee for a single act.

[21]Medicare payments comprise two elements. First, Medicare makes "direct" payments, which are determined based upon the number of residents employed by the hospital. 42 CFR § 413.86. Second, Medicare makes "indirect" payments in the form of increases to the teaching hospital's basic diagnostic

care services--the activity for which the resident is being compensated.[22]

Developing the Facts Regarding Direction and Control

As a starting point, the agent should determine (1) the identity of the sponsoring institution, (2) the type and duration of the residency programs at issue in the claim, (3) the number of residents in each program, and (4) whether rotations are performed at participating institutions and the duration of any such rotations. This information may be obtained from the claim, the taxpayer, or from other sources such as the Green Book or through Internet research.[23]

Documentary evidence involving medical residents and sponsoring institution faculty (attending physicians), such as employment contracts and position descriptions, is highly relevant for purposes of determining the facts with respect to behavioral control, financial control, and the relationship of the parties. In addition, the affiliation agreements between the sponsoring institution and any affiliated teaching hospitals are relevant for purposes of determining the parties' intent with respect to the relationship as well as in determining the entity that has the right to direct an control the resident.[24] In this regard, the following documents are relevant in developing the facts in these cases:

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related group (DRG) operating payments. 42 CFR § 412.105.

[22]The August 1999 report to Congress by the Medicare Payment Advisory Commission entitled, Rethinking Medicare's Payment Policies for Graduate Medical Education and Teaching Hospitals, page 8, describes resident stipends as follows:

> Residents earn a stipend because they provide patient care and perform other services that are of value to the hospital. Other things being equal, this stipend reflects the value of services residents furnish minus the cost of their training. The direct cost of their training is reflected in the remaining direct GME expenses for faculty supervision, administrative staff, and faculty overhead. In principle then, the direct GME costs that hospitals report on their Medicare cost reports represent the net value of the patient care services residents provide.

[23]General information regarding the residency program at issue can likely be obtained through Internet research, including FREIDA online (Fellowship and Residency Electronic Interactive Database Access) at www.ama-assn.org//frieda.

[24]Of course the substance of the relationship, not the label placed on it, governs the resident's status. § 31.3121(d)-1(a)(3) of the regulations; Bartels, supra (the Supreme Court determined that orchestra leader was the employer of the orchestra members despite contracts which designated the dance halls where the orchestra performed as the common law employer). However, the designation or description of the relationship is important in close cases. See Illinois Tri Seal Prods. Inc., v. United States, 353 F.2d 216, 218 (Ct. Cl. 1965).

- Any written policies/procedures relating to limits on the patient service aspects of the program.
- Any contracts/affiliation agreements between the sponsoring institution and the participating institution(s) with respect to the GME program.
- Any agreements a resident must sign upon entering the residency program.[25] (Determine if there are additional agreements signed as the training program progresses).
- A resident handbook or bulletin, if any, provided to residents.
- Position description(s) for Medical Residents, if any. Does the position description change as the training program progresses?
- Any contracts between the sponsoring institution and its attending physicians/faculty members that address the attending physicians' responsibilities with respect to the supervision of resident patient care services. Check on whether separate contracts exist between the participating hospitals and the attending physicians with respect to the supervision of resident services.
- The sponsoring institution's position description(s), if any, for an attending physician/faculty member. What does the position description say with respect to the supervision of resident services or the training/education of residents?

In addition, if the residency program is accredited, the specific program requirements as set forth by the accrediting body should be reviewed to identify any other pertinent documents.[26]

In determining whether an individual is an employee under the common law rules, case law and rulings have looked to a variety of facts as indicating whether sufficient control is present to establish an employer-employee relationship. As noted above, the same facts will determine which of two entities is the employer. The degree of importance of the facts varies depending upon the occupation and the factual context in which the services are performed. See Revenue Ruling 87-41, 1987-1 C.B. 296, 298-99. To analyze the relevant facts, items of evidence can be grouped into the following three main categories: behavioral control, financial control, and the relationship of the parties.

1. **Behavioral control**. Evidence in this category include facts regarding whether a business has the right to direct and control how the worker performs the specific tasks for which the worker is hired. Facts that show behavioral control include the type and degree of instructions given to the worker and the training the

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[25]The ACGME requires a written agreement setting forth the conditions of the appointment.

[26]See supra, note 4.

business gives the worker. It is important to remember that there will typically be some facts indicating behavioral control by both the sponsoring and participating institutions.

There are certain facts which will generally be consistent from case to case which indicate that a hospital where services are performed has behavioral control over residents. The hospital will generally determine the hours a resident is to work.[27] In addition, the hospital receives payment for resident patient care services, including Medicare reimbursement; thus creating an incentive to monitor their services.

There are other facts which are properly viewed as neutral facts because they are common to all hospital-physician relationships. These include the facts that the services will be performed on the hospital's premises, the hospital sets policies and procedures with respect to patient care, and the resident will generally use the hospital's equipment, facilities and support staff. Instead, facts indicating that the hospital generally has more detailed policies and procedures with respect to patient care services performed by residents than for other physicians are more relevant for purposes of determining behavioral control (see facts to be developed below).

Certain facts will typically indicate that the sponsoring institution has behavioral control over residents. Sponsoring institution faculty provide instructions and training to residents with respect to the provision of patient care services. These instructions may be very detailed, especially in the early years of a residency. Also, an accredited sponsoring institution will have an evaluation system in place which serves as means to direct and control the performance of services by a medical resident.

Other facts to be developed with respect to behavioral control include:

- To what extent does the hospital or sponsoring institution require the resident to make time/activity reports?
- Do the contracts/affiliation agreements between the sponsoring institution and the participating hospitals address supervision of resident patient care services? Do these contracts designate an entity as the employer having the

[27] In New York, the hospital is responsible for seeing that the so-called "Libby Zion regulations" are followed. These regulations, which are set forth at § 405.4 of the New York Health Code (10 NYCRR 405.4), require that the hospital establish certain limits and monitor the working hours of medical residents. These regulations also require that hospitals adopt and enforce specific policies regarding moonlighting to ensure that medical residents are not fatigued when performing patient care services. Similar laws do not exist in other states, but limits may be imposed by the programs.

right to direct and control the medical residents? Do these contracts designate an entity that would be liable in the event of resident negligence?

- Does the hospital have in place separate safeguards/controls or policies, possibly set forth in a "house staff manual," governing patient care services performed by residents? Are any of these special procedures mandated by federal or state law (such as Medicare)?
- Do contracts with faculty/attending physicians address supervision of patient care services performed by residents?
- What procedures are in place with respect to attending physicians' reporting to the sponsoring institution regarding a resident's performance? Are there forms used for this purpose?
- To what extent are residents subject to less supervision as their training program progresses? To what extent do more senior medical residents (second year residents and beyond) supervise less senior residents?
- Does the hospital or the sponsoring institution assign the attending physicians who are to supervise the resident's services?

2. **Financial Control.** Evidence under this category include facts regarding whether there is a right to direct and control how the economic aspects of the worker's activities are conducted. The fact that the sponsoring institution generally pays the residents notwithstanding whether it receives payment from the participating hospital suggests financial control by the sponsoring institution. With respect to financial control, other facts to be developed include:

- Does the hospital or the sponsoring institution provide medical malpractice insurance to residents?
- Does the hospital or sponsoring institution have a policy with respect to outside employment? Does any such policy change as the resident proceeds through the residency program?
- If the resident incurs expenses that are reimbursable, which entity reimburses them?
- Do the participating hospitals provide benefits to residents in addition to the stipend and benefits (if any) paid to the resident by the sponsoring institution?

3. **Relationship of the Parties.** Evidence under this category includes facts which illustrate how the parties perceive their relationship. Relevant facts include those which show the intent of the parties with respect to control.

Certain facts suggest that the parties perceive the sponsoring institution to be the employer. Residents might have a more permanent relationship with the sponsoring institution than with a hospital where services are performed. In addition, the sponsoring institution can terminate the resident for failure to make satisfactory progress in the training program.

On the other hand, the services performed by residents for a hospital are a key aspect of the regular business of the hospital. As a result, there is an increased probability that the hospital will direct and control their activities. Other facts relevant to how the parties perceive their relationship include:

- Did the hospital where services were performed play any role in determining which candidates were accepted into the residency program or which residents would be assigned to the hospital?
- Did either entity provide the resident with benefits normally associated with an employment relationship such as retirement, worker's compensation, health care, and vacation benefits?
- In the case of poor performance by the resident, does the hospital have the authority to terminate the resident or preclude the resident from performing further services at the hospital?
- Did the hospital independently verify that a resident had the required license/credentials?
- Do contracts between the sponsoring institution and residents place an employer-employee label on the relationship?
- Do contracts between the sponsoring institution and participating hospitals state that either party is the residents' employer?
- Does state law place any particular status on residents? For example, does state law classify them as employees for worker's compensation insurance purposes? Has the hospital ever used state worker's compensation laws to limit liability with respect to a claim made by a resident?
- Have the residents attempted to negotiate collectively with the sponsoring institution or participating hospitals?

Based upon the facts and circumstances, if it is determined that the common law employer is a state or local government entity, such as a state university, it must be determined whether the resident's services are covered under a § 218 agreement.

FICA Coverage of State and Local Government Employees

FICA taxes can apply to services performed by residents who are state and local government employees in either of two ways. First, an employee's service can be covered by a § 218 agreement between the state and the SSA. Such agreements provide state and local government employees with social security coverage.[28] Second, if an employee's service is not covered under a § 218 agreement, then whether FICA tax applies depends on whether the employee's

[28]Section 3121(b)(7)(E) of the Code provides that service covered under a § 218 agreement constitutes employment for purposes of the FICA.

service is subject to FICA tax under §§ 3101-3126 of the Code. Before 1991, social security coverage of state and local government employees was available only under a § 218 agreement; those employees were excluded from coverage under the FICA. However, since 1991, § 3121(b)(7)(F) provides that state and local government employees are covered under the FICA unless they participate in a retirement system that provides them with minimum retirement benefits that are comparable to the retirement benefits provided under social security.

Section 218 Agreements

If the employer is a state or local government entity, the IRS must determine whether the resident's service is covered by the state's section 218 agreement. When a state enters into a § 218 agreement with the SSA, employees of the state and its political subdivisions are brought under the agreement in groups known as "coverage groups." The Act gives each state the right to decide which coverage groups to include under its § 218 agreement. Coverage groups fall into two categories: employees who are not covered under a state retirement system and employees who are covered under a retirement system. For example, one possible coverage group is the employees of each institution of higher education who are covered under the state retirement system.

Each state designates an official to act for the state in matters involving the SSA and its § 218 agreement. This person is known as the "State Social Security Administrator" (SSSA). Further information on the procedures for obtaining information from SSSA will be provided soon. The State Social Security Administrator or the SSA can help answer questions on whether a particular employer's employees are included within a coverage group. See Exhibit 3 for a list of SSSAs.

The state's § 218 agreement determines which employees within each coverage group are covered by its terms. In addition to certain mandatory exclusions from coverage under a § 218 agreement, § 218(c) of the Act provides that certain services may be excluded from coverage upon election by the state. For example, under § 218(c)(5), a state has the option of excluding the services of students. Section 218(c)(5) provides that the optional exclusion will apply only to students who would be excluded under the general student exclusion provided under § 210(a)(10). Section 210(a)(10) provides for a general exclusion from social security coverage for services performed for a S/C/U (or an organization that is a related § 509(a)(3) organization with respect to the S/C/U) by a student who is enrolled and regularly attending classes at the S/C/U.[29] But if a state chooses not to exclude student services under its agreement, those services will be covered

[29]Section 210(a)(10) of the Act is the parallel provision to § 3121(b)(10) of the Code.

under social security notwithstanding the general student exclusion under § 210(a)(10) of the Act.[30] Thus, if the state covers student services under its § 218 agreement, medical resident services will be covered under the FICA even if the requirements for the student FICA exception are otherwise met.

Even if the state's § 218 agreement excludes students from coverage as permitted by § 218(c)(5) of the Act, the exclusion might not apply to medical residents. This will depend upon whether the resident is a student within the meaning of § 210(a)(10) of the Act. The SSA has jurisdiction over the proper interpretation of § 218 agreements and the pertinent provisions of the Act for purposes of determining whether an individual is entitled to social security benefits, including whether a medical resident is a student within the meaning of § 210(a)(10) of the Act. The SSA litigated the issue of whether residents were covered under a § 218 agreement in State of Minnesota v. Apfel, 151 F.3d 742 (8th Cir. 1998).[31]

State of Minnesota involved medical residents who were enrolled in the GME program at the University of Minnesota ("University"). One issue considered by the court was whether the residents were students within the meaning of § 210(a)(10) of the Act and thus excluded from coverage under Minnesota's § 218 agreement. The SSA asserted that the purpose of the stipends paid to the residents was primarily compensatory and therefore the purpose of the relationship must have been primarily to earn a livelihood. In addition, the SSA cited Social Security Ruling 78-3, which sets forth SSA position that resident physicians are not "students" for purposes of the student services exclusion under § 210(a)(10) of the Act.

In rejecting the SSA's arguments, the court cited 20 C.F.R. § 404.1028(c), which provides that "[w]hether you are a student for purposes of this section depends on your relationship with your employer. If your main purpose is pursuing a course of study rather than earning a livelihood, we consider you to be a student

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[30]Section 2023 of Public Law 105-277 (the Balanced Budget Act), enacted October 21, 1998, provided an exception to the general rule that states may not amend their § 218 agreements to exclude certain groups from coverage. The legislation provided a limited window of time for states to modify their existing § 218 agreements to exclude services performed by students employed by the public school, college, or university where they are regularly attending classes. The legislation provides that to obtain this exclusion, the § 218 agreement must have been modified after December 31, 1998, and before April 1, 1999. Any modification made under this section will be effective with respect to services performed after June 30, 2000.

[31]State of Minnesota involved the tax years 1985 and 1986. Under the Omnibus Budget Reconciliation Act of 1986, Pub. L. No. 99-509, the IRS became responsible for determining liability for social security taxes under a § 218 agreement with respect to remuneration for services paid after December 31, 1986.

and your work is not considered employment." Thus, the court held that it was not determinative that the stipends are paid for services performed; rather, the critical inquiry is the nature of the relationship between the University and the medical residents.[32] The court also rejected SSR 78-3 because its "bright-line rule" is inconsistent with the approach set forth at 20 C.F.R. § 404.1028(c), which contemplates a case-by-case examination of the individual's relationship with the S/C/U.[33] In examining the facts, the court found persuasive that the residents were enrolled at the University, paid tuition, and were registered for approximately fifteen credit hours per semester. Based upon these facts, the court concluded that the primary purpose of the residents' participation in the program was to pursue a course of study rather than to earn a livelihood.[34]

In response to the State of Minnesota decision, the SSA issued Acquiescence Ruling 98-5 (8), 63 F.R. 58444. Ruling 98-5 applies only to employers located in the 8th Circuit (Minnesota, the Dakotas, Nebraska, Iowa, Missouri and Arkansas). The ruling provides that, in applying the student services exclusion within the 8th Circuit, SSA will make a case by case examination of the relationship of medical residents with the employer S/C/U to determine whether the residents meet the statutory criteria of being enrolled and regularly attending classes. In evaluating the relationship, the SSA will consider all the facts and circumstances.

Employer Status Requirement

Under § 3121(b)(10), the Student FICA exception is available only with respect to services performed in the employ of a S/C/U or a related § 509(a)(3) organization. Section 31.3121(b)(10)-2(d) of the regulations provides that the term "school, college, or university" for purposes of the student FICA exception is to be construed in its "commonly or generally accepted sense." A medical school will clearly qualify as a S/C/U. However, if the hospital where services are performed is the common law employer, but is not part of the medical school, the question arises whether the hospital qualifies as a S/C/U or a related § 509(a)(3) organization to a S/C/U.

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[32] 151 F.3d at 747.

[33] Id. at 748.

[34] Id.

Revenue Procedure 98-16

Revenue Procedure 98-16, 1998-5 I.R.B. 19, sets forth generally applicable standards for determining whether services performed by students in the employ of certain institutions of higher education qualify for the exception from FICA tax provided under § 3121(b)(10). For purposes of Rev. Proc. 98-16, the term "institution of higher education" includes any public or private nonprofit school, college, university, or affiliated organization described in § 509(a)(3) of the Code that meets the requirements set forth in Department of Education (DOE) regulations at 34 C.F.R. § 600.4. These regulations define an institution of higher education, in relevant part, as an institution that (1) is in a state, (2) admits only high school graduates, (3) is authorized by the state to provide a post-secondary educational program, and (4) is accredited or preaccredited by a "nationally recognized accrediting agency" as defined in the DOE regulations at 34 C.F.R. § 600.2.

The revenue procedure provides at § 2.02 that the standards contained in it do not apply to the treatment of postdoctoral students, postdoctoral fellows, medical residents, or medical interns because services performed by these employees cannot be presumed to be for the purpose of pursuing a course of study. Thus, whether a hospital is a S/C/U must be considered in light of the "commonly or generally accepted sense" test set forth in the regulations. While the tests under the DOE regulations are relevant in determining whether a hospital may be considered a S/C/U for purposes of § 3121(b)(10), whether any hospital meets or fails to meet the DOE standards is not a controlling standard as it is in the case of an institution that seeks to use the safe harbor of the revenue procedure.[35] However, we believe that a hospital that is not part of the same legal entity as a medical school or university generally does not fit within the common or generally accepted meaning of the term "school, college, or university."[36]

Is the Hospital Part of the Medical School or University?

If the resident is employed by a hospital that is part of a university, the question arises whether the hospital is a separate employer from the university.

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[35]We note that the ACGME is not a "nationally recognized accrediting agency" within the meaning of the regulations at 34 CFR § 600.2. It is our understanding that the ACGME has not sought recognition by the DOE as a nationally recognized accrediting agency.

[36]In construing a statute, courts generally seek the plain and literal meaning of its language. United States v. Locke, 471 U.S. 84, 93, 95-96 (1985). More specifically, words in a revenue act generally are interpreted in their " 'ordinary, everyday senses.' " Commissioner v. Soliman, 506 U.S. 168, 174 (1993) (quoting Malat v. Riddell, 382 U.S. 669, 571 (1966) (quoting Crane v. Commissioner 331 U.S. 1, 6 (1947))); see also Helvering v. Horst, 311 U.S. 112, 118 (1940) ("[c]ommon understanding and experience are the touchstones for the interpretation of revenue laws.").

This is important because, as stated, a university medical school is clearly a S/C/U, whereas a hospital generally is not. If they are incorporated separately under state law, they are separate legal entities for purposes of applying the employment tax provisions, including the student FICA exception. A simple starting point in making this determination is whether the hospital and the university have different EINs. If they have different EINs, they generally should be separate employers and assertions that they are not should be carefully examined.

If the hospital and medical school report wages under the same EIN, they may or may not be a single employer. Even if wages paid to university employees and medical residents are reported under the same EIN, the university may be merely acting as a common paymaster under § 3121(s) with respect to wages paid by the two separate legal entities. Thus, if wages are reported under the same EIN, it must be determined whether the university hospital is incorporated separately under state law.

If the hospital and university medical school are separate employers, the employer status requirement is not met unless the hospital is a § 509(a)(3) organization in relation to the S/C/U.[37]

Section 509(a)(3) Organizations

Under § 3121(b)(10)(B) of the Code, the student FICA exception may be available if a hospital is a related § 509(a)(3) organization with respect to an affiliated S/C/U. Some other type of affiliation between the hospital and a S/C/U is not enough. Section 3121(b)(10)(B) and § 31.3121(b)(10)-2(a)(2) of the regulations are very specific about the relationship required when the employer is not a S/C/U. It appears that the word “affiliated” in § 31.3121(b)(10)-2(b) and (c) of the regulations has caused some tax advisors to believe that a contractual relationship created by an affiliation agreement with a participating institution is sufficient to satisfy the employer status requirement. It is not; "affiliated" when used in § 31.3121(b)(10)-2(b) and (c) means having a § 509(a)(3) relationship. Any other interpretation would be inconsistent not only with § 31.3121(b)(10)-2(a)(2), but also with § 3121(b)(10)(B), that is, the statute itself.[38]

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[37]Note that State of Minnesota does not stand for the proposition that a university hospital and a university medical school are a single employer for purposes of § 3121(b)(10). The case involved the interpretation of the State’s § 218 agreement which referred only to employees of the University of Minnesota generally. As discussed above, the court did not address the issue of whether the University was the common law employer.

[38]Note also that State of Minnesota does not establish a legal basis for accepting any relationship other than a § 509(a)(3) relationship. As discussed above, the court did not consider or decide the question of whether the University was in fact the employer of the medical residents. In addition, State

Section 3121(b)(10)(B) provides that the student FICA exception applies with respect to services performed in the employ of an organization described in § 509(a)(3) if (1) the organization is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions, or to carry out the purpose of a S/C/U, and (2) is operated, supervised and controlled by or in connection with the S/C/U. This section's language incorporates the tests set forth under § 509(a)(3)(A) and (B) of the Code. In addition, § 509(a)(3)(C) requires that the § 509(a)(3) organization may not be controlled, directly or indirectly, by disqualified persons (as defined in § 4946). Thus, a § 509(a)(3) organization must meet four requirements:

(1) An organizational test (§ 509(a)(3)(A)).
(2) An operational test under § 509(a)(3).
(3) A relationship test (§ 509(a)(3)(B)).
(4) An absence of disqualified persons (§ 509(a)(3)(C)).

If the taxpayer is claiming that the employer-status requirement is met by virtue of the fact that it is § 509(a)(3) organization in relation to a S/C/U, the taxpayer's organizing instruments (articles of incorporation and bylaws) must be analyzed to determine whether the organizational test has been met.[39]

For a hospital that is part of a university, the "organizational" and "absence of disqualified persons" tests will generally be met. In addition to being organized as a § 509(a)(3) organization, the entity must also at all times be operated exclusively for the benefit of, to perform the functions of or to carry out the purposes of the S/C/U. The organization's actual activities must be analyzed to determine whether the operational test is met.[40]

The relationship test offers three alternatives for qualification:

The hospital would have to be:

(1) Operated, supervised or controlled by the university.
(2) Supervised or controlled in connection with the university.
(3) Operated in connection with the university.

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of Minnesota does not stand for the proposition that a university hospital is a S/C/U because, to the extent that the employer's status as a S/C/U was relevant, it would have been taken for granted since the University was assumed to be the employer.

[39]See Income Tax regulations § 1.509(a)-4(c).

[40]See Income Tax regulations § 1.509(a)-4(e).

The relationship under the first test is comparable to a parent/subsidiary relationship and is established by fact that a majority of the officers, directors or trustees of the hospital are elected or appointed by the university. The relationship under the second test contemplates a brother/sister relationship. This is established by finding common supervision or control by persons supervising or controlling both organizations. The third test contemplates two independent organizations but with a strong commonality of purpose and operation. This test is met if the hospital is both "responsive to" the university and operates as an "integral part" of the university.[41]

If the common law employer is other than a medical school, it should be considered whether the common law employer is a related § 509(a)(3) organization. For example, if a university hospital associated with a university medical school is the common law employer (and if the university hospital is not part of the same legal entity as a university or university hospital), the IRS should consider whether the hospital is a related § 509(a)(3) organization by virtue of the hospital's relationship with the university or the university medical school. We note that, as stated, the existence of an affiliation agreement, without more, will not render a participating institution a related § 509(a)(3) organization.

Similarly, if a medical school faculty practice plan (which is not part of the same legal entity as the medical school or university) is the common law employer, the IRS should determine whether the faculty practice plan is a related § 509(a)(3) organization with respect to the university or the university medical school.

Although an entity is a related § 509(a)(3) organization, the student FICA exception might not be available if the S/C/U is a state or local government employer. Under § 3121(b)(10)(B), if the related S/C/U is an entity that participates in a state's § 218 agreement, and that state has chosen to cover students under its agreement, then the student FICA exception is not available to the related § 509(a)(3) organization. The legislative history to this provision states that "[§ 3121(b)(10)(B)] would not exclude from coverage services of a student for an auxiliary nonprofit organization connected with a public school, college, or university whose student employees are covered under social security pursuant to a State coverage agreement with the Secretary."[42] Thus, although the employees of the § 509(a)(3) organization are not themselves covered under a § 218 agreement, § 3121(b)(10)(B) requires that the IRS look to the § 218 agreement for purposes of determining whether the student FICA exception is even available.

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[41]The responsiveness and integral part tests are set forth in the regulations at § 1.509(a)-4(i).

[42]H.R. Rep. No. 231, 92d Cong., 1st Sess. 63 (1971); S. Rep. No. 1220 92d Cong., 2d Sess. 150 (1972).

To summarize, the employer status requirement is met only if the employer is a S/C/U or a related § 509(a)(3) organization. A medical school is a S/C/U within the meaning of § 3121(b)(10). A hospital, standing alone, would generally not be considered a S/C/U for purposes of the student FICA exception because it is not a S/C/U within the common or generally accepted sense. However, an entity such as a university hospital may be considered a S/C/U either because it is part of the same legal entity as the university or because it is a related § 509(a)(3) organization. A faculty practice plan may also satisfy the S/C/U requirement if it is a related § 509(a)(3) organization. If the S/C/U is a state or local government entity, the student FICA exception is not available with respect to services performed for the related § 509(a)(3) organization if the state has chosen to cover student services under its § 218 agreement.

The Student Status Requirement

In addition to the employer status requirement under § 3121(b)(10), a resident with respect to whom the refund claim is filed must be a "student who is enrolled and regularly attending classes at [the S/C/U]." Section 31.3121(b)(10)-2(c) of the regulations provides that whether an employee has the status of a student is determined on the basis of the employee's relationship with the S/C/U for which the services are being performed. An employee who performs services in the employ of a S/C/U "as an incident to and for the purpose of pursuing a course of study" at the S/C/U has the status of a student in the performance of those services. Section 31.3121(b)(10)-2(b) provides that if an employee has the status of a student, then "the amount of remuneration for services performed by the employee in the calendar quarter,[43] 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. Thus, the fact that a resident's pay is higher than students generally or much lower than a board certified physician is irrelevant. In addition, the fact that residents provide patient care services does not of itself preclude student status.

Although we believe the employer status requirement is not met in the case of a resident who participates in a hospital-sponsored residency program (if the

[43]Before 1950, services performed by a student enrolled and regularly attending classes for a S/C/U not exempt from income tax were not "employment" to the extent the remuneration for these services did not exceed $45 in a calendar quarter; however, remuneration for student services performed for a S/C/U exempt from income tax were not subject to a dollar limit per quarter. Social Security Act Amendments of 1939, Pub. L. No. 76-379, §§ 201, 606, 53 Stat. 1360, 1374-75, 1384-85 (1939). In 1950, the quarterly limit on remuneration paid to an employee/student of a nonexempt S/C/U was eliminated and the separate student exclusion provisions for exempt and nonexempt entities were combined. Social Security Amendments of 1950, Pub. L. No. 81-734, § 104(a), 64 Stat. 477, 497, 531 (1950).

hospital is not a related § 509(a)(3) organization), we recommend that in all cases the facts regarding student status be developed.

Even though Revenue Procedure 98-16 provides that the objective standards contained in the revenue procedure do not apply to, inter alia, medical residents because the services performed by medical residents cannot be assumed to be incidental to and for the purpose of pursuing a course of study, this does not mean they cannot be students. Instead, it means that determination of the status of these employees as students requires examination of the facts and circumstances and cannot be determined only by reference to the guidelines set forth in Revenue Procedure 98-16. A per se position that medical residents are not students within the meaning of § 3121(b)(10) would be inconsistent with the regulations and Revenue Procedure 98-16.[44]

Although State of Minnesota involved status as a student under § 210(a)(10) of the Act, it is instructive as to the facts and circumstances a court may consider in determining student status. In State of Minnesota, the court framed the issue by stating that "if the residents' participation in University's training program is primarily educational, the residents should be considered students. If their purpose is to earn a living, however, they do not fit within the definition of student exclusion."[45] In determining whether the services were primarily educational or for the purpose of earning a living, the court found persuasive the facts that the residents were enrolled at the University, paid tuition, and were registered for approximately fifteen credit hours per semester.

Developing The Facts Regarding Student Status

As an initial matter, if the residency program is accredited, the educational program requirements of the accrediting body should be determined. For example, in the case of an ACGME-accredited residency program, the ACGME educational program requirements for the type of residency program should be determined.[46] If

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[44]We note, however, that based upon the description of residents' day to day activities and responsibilities in the recent NLRB decision (Boston Medical Center and Committee of Interns and Residents, 330 NLRB No. 30, 1999 NLRB Lexis 821) and the recent series of articles in the New York Times (N.R. Kleinfield, Life, Death, and Managed Care, November 14-17, 1999), it would be difficult to characterize residents' activities as primarily for the purpose of pursuing a course of study. See also, S. Jauhar, Medical Residents, Yes, But Workers, Too, New York Times, April 18, 2000.

[45]151 F.3d at 748.

[46]The educational program requirements may vary based on the type of residency program. For example, the ACGME education program requirements for internal medicine appear to be more detailed than those for Radiology. Compare the Green Book requirements for internal medicine (page 96) with

a formal educational program existed, the facts should be developed regarding whether the educational program was followed in practice.

The following are relevant facts and circumstances to be developed in addition to those found to be relevant in State of Minnesota:

- How are residents taught? For example, are there regularly scheduled lectures and classroom time? Do the residents participate in formal "teaching rounds"? If so, is there a record of the teaching rounds that have taken place?
- Are the medical residents evaluated by faculty members of the S/C/U based upon academic standards? Is there a standard program of tasks/assignments based upon increased knowledge and performance evaluations?
- Can a resident be terminated from the residency program for failure to meet academic standards (which may, of course, include clinical performance)?
- Are the residents required to take exams or prepare research projects?
- What percentage of the residents' time is spent in direct patient contact versus the time spent in classroom study or formal teaching rounds?
- What percentage of patient care time is spent in patient care in which the resident's actions must be approved in advance?
- If a university is the employer, how is the resident classified by the university? (Can the resident receive the benefits that other students are entitled to such as student health insurance, discount event tickets, student housing, and library access?)
- Will the training program lead to obtaining a degree or certificate?
- Is the resident provided with benefits, e.g., sick leave, disability coverage, vacation, eligibility to participate in a retirement plan, which are typically associated with career employment status?
- If the employer has a section 403(b) plan, does the employer treat residents as eligible to participate in the plan?

It must be determined whether the facts and circumstances relative to student status change as the resident proceeds from one year to the next through the program. For example, does the amount of classroom time or other didactic activities change after the first year of residency? If formal teaching rounds are part of the educational program, does the time spent on teaching rounds as opposed to "management rounds" or "work rounds," which are not primarily for the

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those for radiology (page 321).

purpose of teaching, change as the training program progresses?[47] In addition, does a resident at some stage in the residency become actively involved in supervising less experienced residents?

The Resident Must Have Been Enrolled and Regularly Attending Classes

The student must be "enrolled and regularly attending classes" at the S/C/U. This language may be read to suggest that Congress envisioned a traditional classroom environment. The question therefore arises whether the employee must participate in traditional classroom activity or whether other didactic activities, including research activities and supervised practice, may fulfill this requirement. Revenue Ruling 78-17, 1978-1 C.B. 306, situation 3, considered whether services performed for a university by a Doctor of Education student, who was conducting research and experimentation needed for the student's dissertation, were excepted under the student FICA exception. The IRS concluded that the service was excepted from employment because the dissertation was required to obtain the desired academic degree and the student was actually enrolled at the university. Thus, the ruling carves out an exception to the "regularly attending classes" requirement in circumstances where the employee is enrolled at the university and is completing the requirements for an academic degree.

We do not believe "classes" should be interpreted narrowly to include merely traditional lecture/discussion and lab sessions. Instead, regularly scheduled events, whether or not in a classroom, including lectures, demonstrations, tutorials, and teaching rounds at which a faculty member plays a leadership role in furthering the objectives of an established curriculum may be considered classes for purposes of the student FICA exception. The frequency of events such as these determines whether the medical resident may be considered to be "regularly attending classes."

It should be noted that residency programs fulfill the requirements for certification in a particular specialty area and thus are similar in some respects to the requirements that other professionals such as architects and accountants must meet to receive licensing/certification. For example, accountants undergo a similar post-secondary process. Accountants must obtain a Bachelor's degree and complete a period of work experience before being eligible for a Public Accountant's license.[48] Similarly, architects must complete a five-year bachelor of

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[47] See, e.g., Green Book, page 97 (in describing the formal teaching program requirements for internal medicine residency programs, the ACGME distinguishes between teaching rounds, which are intended to be for educational purposes, and "management rounds" and "work rounds," which appear to be primarily for the purpose of ensuring adequate patient care).

[48] Information obtained from the American Institute of Certified Public Accountants (AICPA).

arts program or a six-year masters program followed by a working internship which generally lasts three years. After completing the internship, the architect may take a certification exam, which the architect must pass in order to become fully licensed.[49]

To summarize, whether a medical resident is a student depends upon examination of all the facts and circumstances. A particular claim should be examined on a program by program and a year by year basis . Thus, the written educational program of each residency program should be reviewed and it should be determined whether this written educational program changes from year to year as a residency progresses. It is also necessary to determine how the program operates in practice; in other words, whether in practice the written program requirements have been followed. In this regard, any contemporaneous records of events such a teaching rounds, seminars and other activities as described above as being the equivalent to classroom activities are highly relevant in determining whether the resident is a student.

Refund Claim Procedures Must be Followed

The employer must fulfill certain procedural requirements in order to receive a refund of the employer and employee portions of FICA tax. Generally, the employer has a duty to first "adjust" the employee portion of FICA as a condition to receiving a refund for the employer and employee portions of FICA.[50] The following provisions describe the conditions which must be met in order for an employer to receive a refund of employee and employer portions of FICA, and under what circumstances an employer can receive a refund of only the employer portion of FICA.[51]

Section 6413(a) of the Code provides that if more than the correct amount of employer or employee FICA tax is paid on any payment of remuneration, proper adjustments, of both the tax and the amount to be deducted, must be made, without interest, as prescribed by regulations.

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[49]Information obtained from the American Institute of Architects (AIA).

[50]Atlantic Department Stores, Inc v. United States, 557 F.2d 957 (2d Cir. 1977). See also, Rev. Proc. 81-69, 1981-2 C.B. 726.

[51]Fulfilling these requirements is not a jurisdictional requirement; thus, these requirements need not be satisfied at the time the claim is filed. Rather, these requirements are a prerequisite to the IRS being required to pay a refund claim. Chicago Milwaukee Corporation v. United States, 40 F.3d 373; GCM 38,786.

Section 6413(b) of the Code provides that if more than the correct amount of employer or employee FICA tax is paid on any remuneration, and the overpayment cannot be adjusted under section 6413(a) (because the overpayment relates to a period with respect to which the return has already been filed), the amount of the overpayment must be refunded as prescribed by regulations.

Section 31.6413(a)-1(b)(1)(i) of the regulations provides that when the employer ascertains that it has paid more than the correct amount of employee tax under section 3101 after the return reporting the payment has been filed, the employer "shall repay or reimburse the employee" if the error is ascertained within the applicable limitations period. However, the employer is exempted from the refund requirement if the overcollection and overpayment to the district director is "made the subject of a claim . . . for refund or credit, and the employer elects to secure the written consent of the employee to the allowance of the refund or credit under the procedure provided in [§ 31.6402(a)-2(a)(2)(i)]."

Section 31.6402(a)-2(a)(2)(i) of the regulations provides that every claim for refund or credit of employee tax under § 3101 collected from an employee shall include a statement that the employer has repaid the tax to such employee or has secured a written consent of such employee to the allowance of the refund or credit.

Section 31.6402(a)-2(a)(2)(ii) of the regulations provides that if the claim relates to employee tax collected in a year prior to the year in which the credit or refund is claimed, the employer must also submit a statement that it has obtained from the employee a written statement (a) that the employee has not claimed refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and (b) that the employee will not claim a refund or credit of such amount.

Revenue Ruling 81-310, 1981-2 C.B. 241, considered whether attempting to secure employee consents to the allowance of refunds in accordance with § 31.6402(a)-2(a)(2)(i) of the regulations would fulfill the employer's duty to first adjust overpaid employee FICA tax so that the employer could claim a refund of the employer portion of FICA. The ruling holds that when the employer notifies its employees of the overpaid employee FICA tax, and requests their consents to its filing a refund claim on their behalf, it has made reasonable efforts to protect their interests. Thus, the employer's notification and request for employee consents should be treated as fulfilling its duty to first "adjust" employee overcollection even if the employee refuses to sign a consent.

To summarize, a taxpayer may receive a refund of the employee portion of FICA collected in a year prior to the year in which the refund claim is made only if the taxpayer provides a statement that (1) the taxpayer has obtained the

employee's consent to the allowance of the refund and (2) that it has obtained a statement from the employee that the employee has not claimed (or if claimed, it has been rejected) and will not claim a refund for such amount. Thus, in examining a resident refund claim involving both portions of FICA, resident consents (or a sample of consents) should be requested from the taxpayer prior to approval of the claim. If the employer is claiming a refund of just its portion of FICA, the employer must provide a statement that it has made reasonable attempts to first adjust the employee's account, which generally means that the employer has notified the employee and requested the employee's consent.

Conclusion

The first step in any medical resident refund case is to identify the common law employer. Identifying the common law employer is critical for two reasons. First, if the common law employer is a state or local government entity, resident services may be covered under a § 218 agreement with the SSA. Second, the student FICA exception applies only if the common law employer is a S/C/U or a related § 509(a)(3) organization. A medical school is a S/C/U within the meaning of § 3121(b)(10). A hospital is generally not a S/C/U; however, service performed for a hospital may qualify for the student FICA exception if the hospital is a related § 509(a)(3) organization. Whether a resident is a student depends upon examination of all the facts and circumstances. The student FICA exception is available only with respect to students who are enrolled and regularly attending classes. If it is determined that the student FICA exception requirements have been met, then the taxpayer seeking a refund of employment taxes must satisfy certain procedural requirements.

Appendix

1965 Revocation of the Medical Intern Exception

The legislative history underlying the Social Security Amendments of 1965, Pub. L. No. 89-97 (SSA of 1965) indicate Congress' intent that medical residents be covered under the FICA. Prior to the SSA of 1965, § 3121(b)(13) of the 1954 Code excluded from the definition of employment "service performed as an intern in the employ of a hospital by an individual who has completed a 4 years' course in a medical school chartered or approved pursuant to State law." Section 311(b)(5) of the SSA of 1965 amended § 3121(b)(13) by striking this provision.

In addition to revoking the medical intern exception, § 311 of the SSA of 1965, entitled, "Coverage for Doctors of Medicine," changed the law in two other ways which affected medical doctors. First, § 1402(c)(5) of the 1954 Code was amended to eliminate the exception from the definition of "trade or business" for physician services (for SECA tax purposes). Second, § 3121(b)(6)(C)(iv) of the 1954 Code, which provided an exclusion from the definition of employment for "service performed in the employ of the United States if the service is performed by any individual as an employee included under § 5351(2) of title 5, [U.S.C.], (relating to certain interns, student nurses, and other student employees of hospitals of the Federal Government)," was amended to add, "other than as a medical or dental intern or a medical or dental resident in training."

These provisions taken together indicate Congress' intent to create a scheme under which all medical doctors are covered under the social security system, whether or not they are still in training, whether or not they are self-employed, or whether or not they work for the federal government.

With respect to the repeal of the medical intern exclusion, the Senate Report states,

> Section 3121(b)(13) of the Internal Revenue Code of 1954 excludes from the term "employment," and thus from coverage under the [FICA], services performed as an intern in the employ of a hospital by an individual who has completed a 4-year course in a medical school . . . . Section 311(b)(5) amended section 3121(b)(13) so as to remove this exclusion. The effect of this amendment is to extend coverage under the [FICA] to such interns unless their services are excluded under provisions other than section 3121(b)(13). Thus, the services of an intern are covered if he is employed by a hospital which is not exempt from income tax as an organization described in section 501(c)(3) of the Code.

After stating that interns are covered under the FICA "unless their services fall within another exclusion," Congress indicates that the exception it had in mind was the exclusion provided under § 3121(b)(8)(B) of the 1954 Code for service performed for tax exempt organizations. If Congress believed that under the FICA, in many cases intern services would be excluded under another section of the Code, such as the student FICA exception, it likely would have said so as it did in the case of services performed for an exempt organization.

The Congressional Record also provides some anecdotal evidence that Congress chose to cover interns along with all other medical doctors under the FICA because young doctors and their families in particular need the protection provided by social security. In speaking against a proposed amendment to strike section 311, Senator Ribicoff of Connecticut recounted the following story:

> A charming, educated woman of the age of 38 came into my office. She had three young children. She had married a young man while he was still in medical school. Her husband had just about reached the stage at which he had gone through an internship, through a residency, and had gone out to the State of Oregon to begin the practice of medicine. He died within a year. The young doctor was indebted because of borrowing to open his practice. He left his widow without a nickel. . . . I believe that we have a problem concerning the coverage of doctors, and that we, as Senators, owe an obligation to the wives and children. We should not seek to exclude them from the coverage of social security.

111 Cong. Rec. 16106 (1965).

Congress' repeal of the medical intern exception in conjunction with the legislative history evidence its concern that young doctors be covered under social security. Thus, Congress' intent would arguably be frustrated by a broad interpretation of the student FICA exception to except all resident services.

Exhibit 1

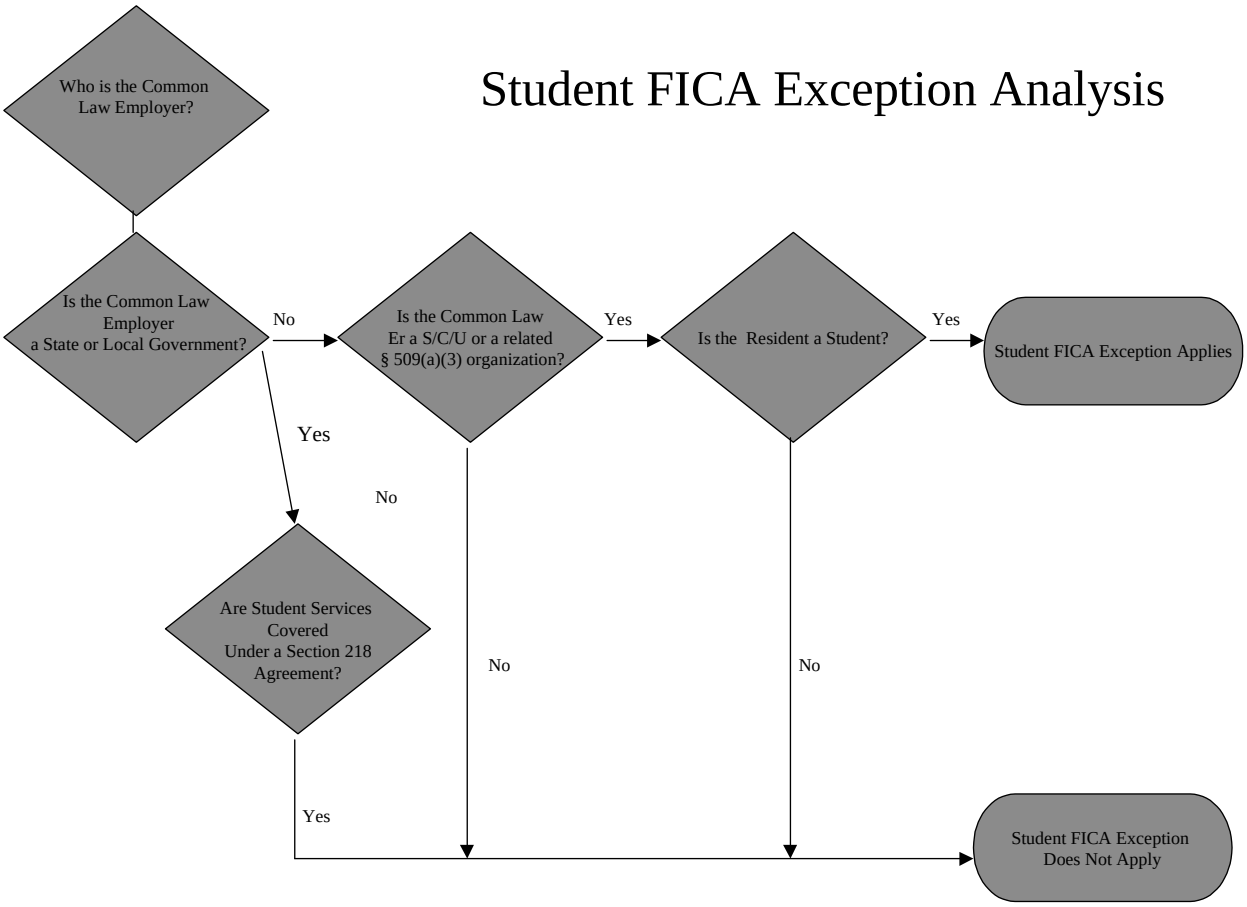
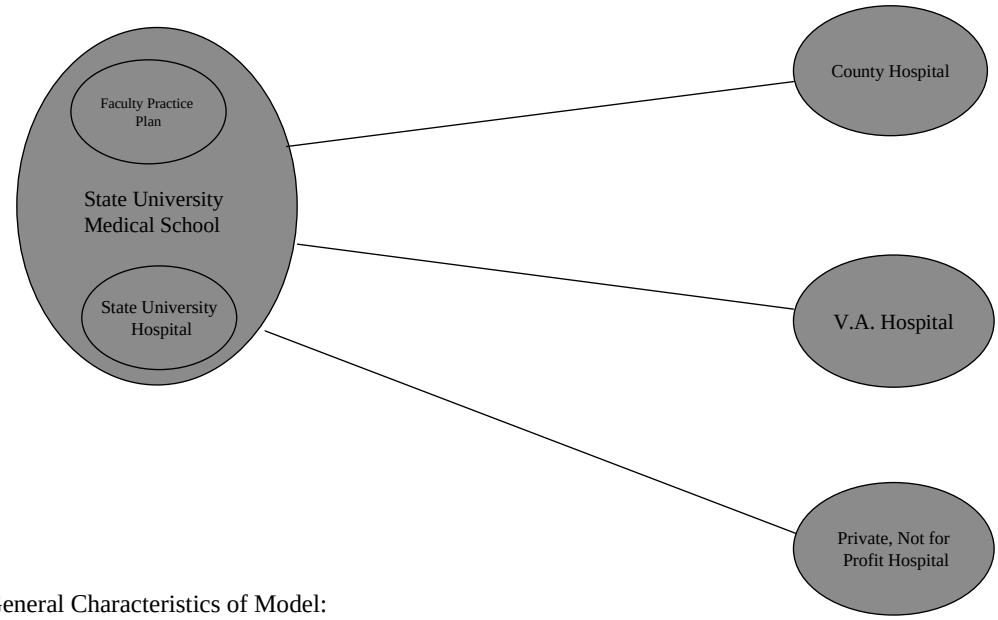

Student FICA Exception Analysis
Who is the Common Law Employer?
Is the Common Law Employer a State or Local Government?
No
Is the Common Law Er a S/C/U or a related § 509(a)(3) organization?
Yes
Is the Resident a Student?
Yes
Student FICA Exception Applies
Yes
No
Are Student Services Covered Under a Section 218 Agreement?
No
No
Yes
Student FICA Exception Does Not Apply

Exhibit 2

Model A

(Participating Institutions)



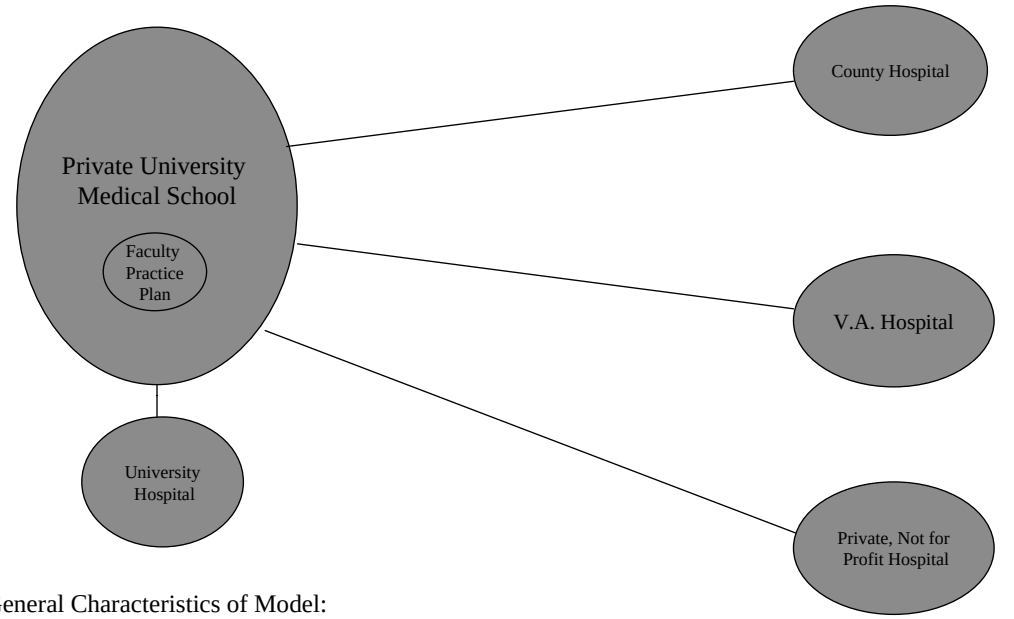
General Characteristics of Model:

- State University Medical School is the Sponsoring Institution.
- State University employees are covered under the State's section 218 agreement, but the State has chosen to exclude student services.
- Residents perform rotations at State University Hospital and Participating Teaching Hospitals.
- State University Hospital is part the same legal entity as the University or the University Medical School.
- Participating Teaching Hospitals have entered into "affiliation agreements" with the State University Medical School.
- Residents are supervised by attending physicians who are "faculty" members of State University Medical School.
- State University has been paying the residents and treating then as employees for employment tax purposes.

Exhibit 2

Model B

(Participating Institutions)

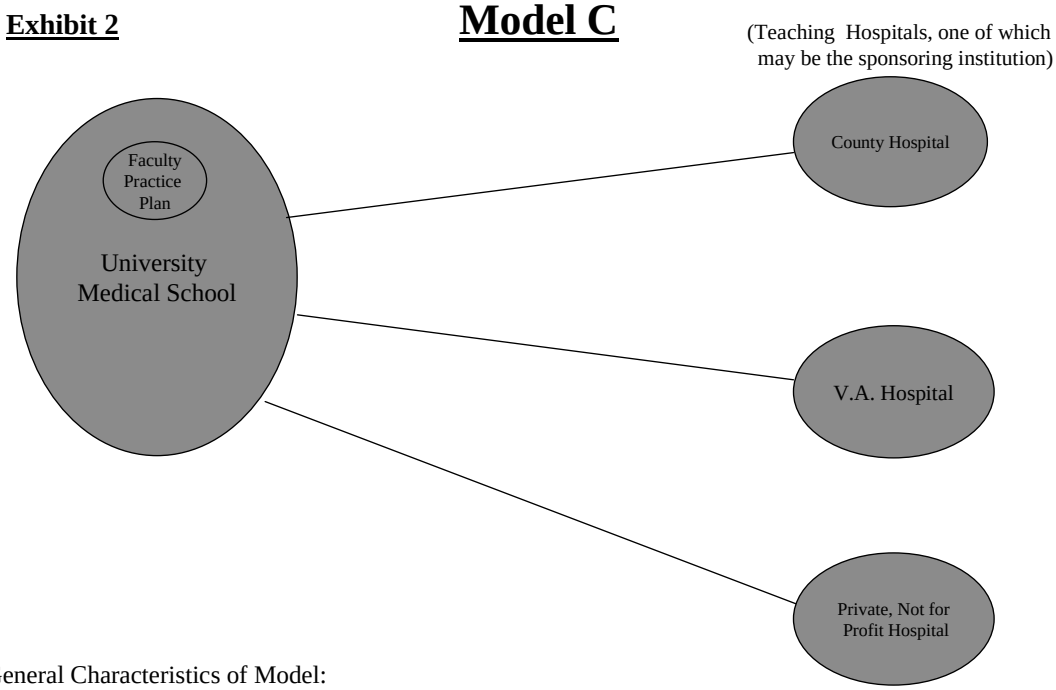


General Characteristics of Model:

- Private University Medical School is the Sponsoring Institution.
- Residents perform rotations at University Hospital and Participating Teaching Hospitals.
- University Hospital is a separate legal entity which may be owned or controlled by the Private University.
- Participating Teaching Hospitals have entered into "affiliation agreements" with the University Medical School.
- Residents are supervised by attending physicians who are "faculty" members of University Medical School.
- University has been paying the residents and treating then as employees for employment tax purposes.

Exhibit 2

Model C

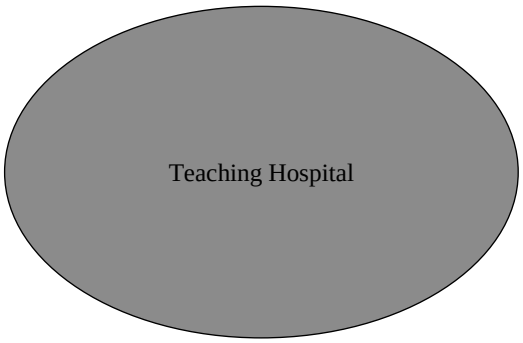


General Characteristics of Model:

- Either a Teaching Hospital or the University Medical School is the sponsoring institution.
- The Teaching hospitals are independent of the University Medical School except for an "affiliation agreement" with respect to the GME program.
- A University Hospital may or may not be part of the overall structure
- Residents perform rotations at Teaching Hospitals.
- Residents are supervised by attending physicians who are "faculty" members of University Medical School.
- Affiliated Teaching Hospitals pay the residents and treat them as employees for employment tax purposes.

Exhibit 2

Model D



General Characteristics of Model:

- Teaching Hospital has no affiliation with a medical school.
- Residents perform services at Teaching Hospital.
- Residents are supervised by attending physicians who are on the staff of Teaching Hospital.
- Teaching Hospital pays the residents and treats them as employees for employment tax purposes.

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