

26 CFR 31.3121(b)(10): Services performed by certain students in the employ of a school, college, or university, or of a nonprofit organization auxiliary to a school, college, or university.

Rev. Proc. 2005-11

SECTION 1. PURPOSE

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

.02 This revenue procedure modifies the safe harbor standards provided in Rev. Proc. 98-16, 1998-1 C.B. 403, in several respects in order to align them with the recently issued final regulations under § 31.3121(b)(10)-2 of the Employment Tax Regulations (T.D. 9167, 2005-2 I.R.B. 261 [69 F.R. 76404]).

SECTION 2. BACKGROUND INFORMATION AND OVERVIEW

.01 Proposed amendments to § 31.3121(b)(10)-2 of the Employment Tax Regulations were issued on February 25, 2004, and were proposed to be applicable with respect to services performed on or after that date (REG-156421-03, 2004-10 I.R.B. 571 [69 F.R. 8604]). Notice 2004-12, 2004-10 I.R.B. 556, issued in conjunction with the proposed amendments, proposed to replace Rev. Proc. 98-16 with a revenue procedure that is consistent with the proposed amendments. Notice 2004-12 provided interim reliance on the proposed revenue procedure as of February 25, 2004, and suspended Rev. Proc. 98-16 pending issuance of the final revenue procedure. Notice 2004-12 requested comments on the proposed revenue procedure. After consideration of the comments that were received, the proposed revenue procedure is adopted as revised by this revenue procedure, and

Rev. Proc. 98-16 is modified and superseded effective April 1, 2005.

.02 This revenue procedure modifies the safe harbor standards of Rev. Proc. 98-16 in several respects in order to align them with the final regulations. First, in order for the safe harbor to be available, in addition to being an “institution of higher education” under the Department of Education’s regulations, as required by Rev. Proc. 98-16, the employer must be a school, college, or university (SCU) as defined in § 31.3121(b)(10)-2(c) of the final regulations, or an affiliated § 509(a)(3) organization with respect to the SCU. The final regulations provide that an organization is not a SCU unless its primary function is to conduct educational activities. The primary function requirement may cause the student FICA exception to be unavailable to certain organizations, such as hospitals and museums, that have embedded within them divisions or functions that carry on educational activities. See section 5 of this revenue procedure.

.03 Second, a “full-time employee” as defined in § 31.3121(b)(10)-2(d)(3)(iii) of the final regulations is ineligible for the student FICA exception. This section provides that the services of a full-time employee are not incident to and for the purpose of pursuing a course of study. Whether an employee is a full-time employee is based on the employer’s standards and practices, except that an employee whose normal work schedule is 40 hours or more per week is always considered a full-time employee. Accordingly, a full-time employee is ineligible for the safe harbor provided in this revenue procedure. See section 6 of this revenue procedure.

.04 Third, the safe harbor is unavailable with respect to the services of a “professional employee” as defined in § 31.3121(b)(10)-2(d)(3)(v)(B)(1) of the final regulations. This section provides that a professional employee is an employee whose work: (1) requires knowledge of an advanced type in a field of science or learning, (2) requires the consistent exercise of discretion and judgment, and (3) is predominantly intellectual and varied in character. Although the safe harbor is unavailable, a professional employee may qualify for the student FICA exception based on consideration of all the

facts and circumstances. See section 6 of this revenue procedure.

.05 Fourth, and finally, this revenue procedure expands the list of employment benefits that cause an employee to be ineligible for the safe harbor. This change is consistent with § 31.3121(b)(10)-2(d)(3)(v)(C) of the final regulations, which provides that eligibility for employment benefits generally suggests that an employee is not a student. Rev. Proc. 98-16 provides that the services of a “career employee” are ineligible for the safe harbor. Under Rev. Proc. 98-16, a career employee is an employee who is eligible to participate in certain retirement plans, eligible for reduced tuition (with certain exceptions), or otherwise classified by the employer as a career employee. The final regulations adopt the same list of employment benefits, and add to the list eligibility for several other employment benefits that are identified. Although the safe harbor is unavailable if an employee receives employment benefits described in this revenue procedure, the employee may qualify for the student FICA exception based on consideration of all the facts and circumstances. See section 6 of this revenue procedure.

.06 Both the final regulations and this revenue procedure are applicable with respect to services performed on or after April 1, 2005. This revenue procedure provides that Rev. Proc. 98-16 is no longer suspended, and employers may rely on it with respect to services performed prior to April 1, 2005, including services performed on or after February 25, 2004, and prior to April 1, 2005. Rev. Proc. 98-16 is modified and superseded with respect to services performed on or after April 1, 2005. See section 10 of this revenue procedure.

SECTION 3. SCOPE

.01 Sections 6 and 7 of this revenue procedure contain generally applicable standards for determining whether services performed by employees of certain institutions of higher education are eligible for the student FICA exception.

.02 The standards contained in this revenue procedure do not apply to employees who are postdoctoral students, postdoctoral fellows, medical residents, or medical interns because the services performed by

these employees cannot be assumed to be incident to and for the purpose of pursuing a course of study. The employment activities of these individuals overlap with the activities arguably comprising a course of study, and thus it is not appropriate to apply the standards of this revenue procedure to these individuals.

.03 The standards contained in this revenue procedure may not constitute the exclusive method for determining whether the student FICA exception applies. If the standard for qualifying for the exclusion described in section 7 of this revenue procedure (providing generally that an employee enrolled at least half-time at an institution of higher education has the status of student) is not met, whether or not services in the employ of a SCU, or an affiliated § 509(a)(3) organization qualify for the student FICA exception will depend on consideration of all the facts and circumstances.

SECTION 4. BACKGROUND LAW

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

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

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

.04 Section 31.3121(b)(10)–2(b) of the final Employment Tax Regulations provides that the tests for determining eligibility for the student FICA exception are (1) whether the employer is a SCU within the meaning of § 31.3121(b)(10)–2(c) of the final regulations, and (2) whether the

employee is a student within the meaning of § 31.3121(b)(10)–2(d) of the final regulations. If the employee has the status of a student, the amount of remuneration for services performed by the employee, the type of services performed by the employee, and the place where the services are performed are immaterial for purposes of the student FICA exception.

.05 Section 31.3121(b)(10)–2(c) of the final regulations provides that an organization is a SCU within the meaning of § 3121(b)(10) if its primary function is the presentation of formal instruction, it normally maintains a regular faculty and curriculum, and it normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on.

.06 Section 31.3121(b)(10)–2(d)(3)(i) of the final regulations provides that in order to have the status of a student, an employee’s services for the SCU must be incident to and for the purpose of pursuing a course of study at the SCU. Whether an employee’s services are incident to and for the purpose of pursuing a course of study is determined on the basis of the relationship of the employee with the organization for which such services are performed as an employee. The educational aspect of the relationship, as compared to the service aspect, must be predominant in order for the employee’s services to be incident to and for the purpose of pursuing a course of study. Except in the case of a full-time employee described in § 31.3121(b)(10)–2(d)(3)(iii) of the final regulations, whether the educational aspect or service aspect of an employee’s relationship with the employer is predominant is determined by considering all the relevant facts and circumstances. Whether an employee’s services are incident to and for the purpose of pursuing a course of study is determined separately with respect to each academic term. Relevant factors in evaluating the educational and service aspects of an employee’s relationship with the employer are described in §§ 31.3121(b)(10)–2(d)(3)(iv) and (v) of the final regulations respectively.

.07 Section 31.3121(b)(10)–2(d)(3)(iii) of the final regulations provides that the services of a full-time employee are not incident to and for the purpose of pursuing a course of study. The determination of whether an employee is a full-time

employee is based on the employer’s standards and practices, except regardless of the employer’s classification of the employee, an employee whose normal work schedule is 40 hours or more per week is considered a full-time employee. The employee’s work schedule during academic breaks is not considered in determining whether the employee’s normal work schedule is 40 hours or more per week.

.08 Section 31.3121(b)(10)–2(d)(3)(iv) of the final regulations provides that the educational aspect of an employee’s relationship with the employer is generally evaluated based on the employee’s course workload. Whether an employee’s course workload is sufficient in order for the employee’s employment to be incident to and for the purpose of pursuing a course of study depends on the particular facts and circumstances. A relevant factor in evaluating an employee’s course workload is the employee’s course workload relative to a full-time course workload at the SCU at which the employee is enrolled and regularly attending classes.

.09 Section 31.3121(b)(10)–2(d)(3)(v) of the final regulations provides certain relevant factors in evaluating the service aspect of an employee’s relationship with the employer. Under § 31.3121(b)(10)–2(d)(3)(v)(B)(1), if an employee has the status of a professional employee, then that suggests the service aspect of the employee’s relationship with the employer is predominant. A professional employee is an employee—

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

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

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

.10 Section 31.3121(b)(10)–2(d)(3)(v)(C) of the final regulations provides that whether an employee is eligible to receive employment benefits is a relevant factor in evaluating the service aspect of an employee’s relationship with the employer. However, eligibility for benefits mandated by law is given a lesser amount of weight in evaluating the relationship.

.11 Section 218 of the Social Security Act (the Act), 42 U.S.C. section 418, requires the Commissioner of Social Security, if requested by a State, to enter into an agreement with the State to provide Social Security coverage for services performed by individuals as employees of such State. The State may request that the coverage agreement exclude from coverage service performed by a student. If a State has exercised its option under § 218 of the Act to provide coverage for its employees, and has not chosen to exclude students from such coverage, § 3121(b)(10) of the Code provides that the services of students will not qualify for the student FICA exception; that is, the students’ services will be covered and the wages will be subject to FICA taxation.

SECTION 5. SAFE HARBOR APPLIES TO CERTAIN INSTITUTIONS OF HIGHER EDUCATION

.01 The standards contained in this revenue procedure apply to an “institution of higher education” meeting the requirements of § 31.3121(b)(10)–2(c) of the final regulations. For purposes of this revenue procedure, the term “institution of higher education” means any public or private nonprofit SCU within the meaning of § 31.3121(b)(10)–2(c), or affiliated § 509(a)(3) organization with respect to the SCU, that meets the requirements set forth in Department of Education regulations at 34 C.F.R. § 600.4, as amended from time to time, and that is accredited or preaccredited by a nationally recognized accrediting agency as defined in the Department of Education regulations at 34 C.F.R. § 600.2.

.02 Services for other institutions may also be eligible for the student FICA exception. Thus, for example, services performed by a student for a secondary school may be eligible for the student FICA exception. Whether or not services for other institutions, such as secondary

schools, qualify for the student FICA exception is determined based on the facts and circumstances of each case.

SECTION 6. SAFE HARBOR NOT AVAILABLE FOR CERTAIN EMPLOYEES

.01 Services performed by an employee with the status of a “full-time employee” within the meaning of § 31.3121(b)(10)–2(d)(3)(iii) of the final regulations are not eligible for the student FICA exception because such services are not incident to and for the purpose of pursuing a course of study. Accordingly, the services of a full-time employee are not eligible for the safe harbor provided under section 7 of this revenue procedure.

.02 Services performed by a “professional employee” within the meaning of § 31.3121(b)(10)–2(d)(3)(v)(B)(1) of the final regulations are not eligible for the safe harbor provided under section 7 of this revenue procedure, because such services cannot generally be considered to be incident to and for the purpose of pursuing a course of study. However, the services of a professional employee may be eligible for the student FICA exception based on consideration of all the facts and circumstances.

.03 Services performed by an employee who receives or is eligible to receive employment benefits as described in this paragraph 6.03 (except as provided in paragraph 6.04 of this revenue procedure) are not eligible for the safe harbor provided under section 7 of this revenue procedure, because such services cannot generally be considered to be incident to and for the purpose of pursuing a course of study. However, the services of an employee who receives or is eligible for employment benefits as described in this paragraph 6.03 may be eligible for the student FICA exception based on consideration of all the facts and circumstances. For purposes of this revenue procedure, an employee’s services are not eligible for the safe harbor provided under section 7 of this revenue procedure if the individual —

(1) Is eligible for vacation, sick leave, or paid holiday benefits;

(2) Is eligible to participate in any retirement plan described in § 401(a) of the Code that is established or maintained by the institution, or would be eligible to par-

ticipate if age and service requirements were met;

(3) Is eligible to receive an allocation of employer contributions other than contributions described in § 402(g) of the Code under an arrangement described in § 403(b) of the Code, or would be eligible to receive such allocations if age and service requirements were met, or if contributions described in § 402(g) of the Code were made by the employee;

(4) Is eligible to receive an annual deferral by nonelective employer contributions under an eligible deferred compensation plan described in § 457(b), or would be eligible for such annual deferrals if plan requirements were met, or if contributions by salary reduction were made by the employee to a plan described in § 457(b);

(5) Is eligible for reduced tuition (other than qualified tuition reduction under § 117(d)(5) of the Code provided to a teaching or research assistant who is a graduate student as described in section 8.03 of this revenue procedure) because of the individual’s employment relationship with the institution; or

(6) Is eligible to receive one or more of the employment benefits described under sections 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), and 137 (adoption assistance) because of the individual’s employment relationship with the institution.

.04 Receipt of or eligibility for an employment benefit as described in paragraph 6.03 of this revenue procedure that is mandated by state or local law will not cause an employee to be ineligible for the safe harbor provided under section 7 of this revenue procedure.

.05 If an individual described in section 6.01, 6.02, or 6.03 of this revenue procedure performs services in multiple job positions, then the individual will with respect to any of those positions be deemed to have the same employee status with respect to all of the positions.

SECTION 7. STANDARDS APPLICABLE TO UNDERGRADUATE AND GRADUATE STUDENTS

.01 An individual who is a half-time undergraduate student or a half-time graduate or professional student and who is not described in section 6.01, 6.02 or 6.03 of this

revenue procedure qualifies for the student FICA exception under this revenue procedure with respect to services performed for an institution of higher education described in section 5 of this revenue procedure at which the employee is enrolled or for an affiliated § 509(a)(3) organization with respect to the institution of higher education. Services performed by a student for any other employer are not covered by the standards of this revenue procedure.

.02 An individual is deemed to be a half-time undergraduate or half-time graduate or professional student if the individual is not described in section 6.01, 6.02, or 6.03 of this revenue procedure and is an undergraduate or graduate student who is in the last semester, trimester, or quarter of a course of study requiring at least two semesters, trimesters, or quarters to complete and is enrolled in the number of credit or unit hours needed to complete the requirements for obtaining a degree, certificate, or other recognized educational credential offered by that institution of higher education even if enrolled in less than half the number required of full-time students.

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

.04 If an individual is described in section 7.01 or 7.02 of this revenue procedure, then all services performed during all payroll periods of a month or less that fall wholly or partially within the academic term are excepted from employment under the student FICA exception.

.05 The student FICA exception does not apply to services performed by an individual who is not enrolled in classes during school breaks of more than five weeks (including summer breaks of more than five weeks), other than services described in section 7.04. See Rev. Rul. 72-142, 1972-1 C.B. 317, and Rev. Rul. 74-109, 1974-1 C.B. 288. However, the student FICA exception applies to employment which continues during normal school breaks of 5 weeks or less during which the individual is not eligible for

the student FICA exception pursuant to section 7.01 of this revenue procedure provided that the individual qualifies for the student FICA exception pursuant to section 7.01 of this revenue procedure on the last day of classes or examinations preceding the break and is eligible to enroll in classes for the first academic period following the break.

.06 If the services performed by a student otherwise described in section 7.01 or 7.02 of this revenue procedure are covered under an agreement pursuant to section 218 of the Act, the student FICA exception does not apply.

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

SECTION 8. DEFINITIONS

For purposes of the standard contained in section 7 of this revenue procedure, the following definitions must be used. For purposes of the following definitions, the term "institution of higher education" means an institution of higher education as defined in section 5 of this revenue procedure.

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

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

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

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

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

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

.04 Half-time graduate or professional student. The term "half-time graduate or professional student" means an enrolled graduate or professional student, as defined in section 8.03 of this revenue procedure, who is carrying at least a half-time academic workload at an institution of higher education as determined by that institution under its standards and practices.

SECTION 9. ANTI-ABUSE RULE

The standards in this revenue procedure must be applied in a reasonable manner, consistent with the purpose of excluding from employment only services that are performed as an incident to and for the purpose of pursuing a course of study at an institution of higher education as defined in section 5 of this revenue procedure. If the standards are inappropriately applied in a manner that conflicts with this underlying purpose so as to manipulate or mischaracterize the nature of the relationship between an employee and an institution of higher education, resulting in the improper avoidance of payment of FICA taxes, then whether the student FICA exception applies will be determined on the basis of all the facts and circumstances (except if the employee is a full-time employee under § 31.3121(b)(10)-2(d)(3)(iii) of the final regulations), rather than on the basis of the specific standards set forth in this revenue procedure. For example, the standards would be inappropriately applied through the manipulation of the relationship between employees and the institution of higher education if a university claimed that the student FICA exception applied to research laboratory workers, who had been full-time employees within the meaning of § 31.3121(b)(10)-2(d)(3)(iii) of the regulations, but were converted to non-full-time employees and required to enroll in a certificate program granting six credit hours per semester for work experience in the laboratory. As another example, if an individual who was not a student worked for a university for many years in a job generally performed by non-students (but nonetheless was not described in section 6.01, 6.02, or 6.03 of this revenue procedure), and then enrolled at the university for six credit hours of course work per semester while continuing to work in the same job, it may be

inappropriate to apply the standards of this revenue procedure to conclude that the individual's work has become incident to and for the purpose of pursuing a course of study solely because the individual enrolled for this course work. In both of these examples, whether the work is performed incident to and for the purpose of pursuing a course of study must be determined on the basis of all the relevant facts and circumstances.

SECTION 10. EFFECT ON OTHER PUBLISHED ITEMS

.01 Rev. Proc. 98-16, 1998-1 C.B. 403, is no longer suspended. Employers may rely on Rev. Proc. 98-16 with respect to services performed prior to April 1, 2005.

.02 Rev. Proc. 98-16 is modified and superseded effective April 1, 2005.

SECTION 11. EFFECTIVE DATE

This revenue procedure is applicable with respect to services performed on or after April 1, 2005 (the date on which T.D.

9167, 2005-2 I.R.B. 261 [69 F.R. 76404], amending § 31.3121(b)(10)-2 is applicable).

SECTION 12. DRAFTING INFORMATION

The principal author of this revenue procedure is Stephen Suetterlein of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue procedure, contact Mr. Suetterlein at (202) 622-6040 (not a toll-free call).

26 CFR 601.202: Closing agreements.
(Also Part I, §§ 446, 482, 7121; 1.446-1, 301.7121-1.)

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