

Internal Revenue Service

Department of the Treasury

Number: **200312012**
Release Date: 3/21/2003
Index Number: 3121.02-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EOEG:ET2-PLR-131661-02

Date:

December 13, 2002

Legend

Taxpayer =
State X =
University =
College of Medicine =
Board of Trustees =
Plan =

Statute A =
Statute B =
Statute C =

Dear :

This is in response to your letter dated June 03, 2002, requesting a ruling on behalf of Taxpayer concerning its liability for taxes under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA). Specifically, you have requested a ruling that Taxpayer and the University are deemed related corporations under section 3121(s) of the Internal Revenue Code (the "Code"), as amended by section 125 of Public Law 98-21, and remuneration disbursed by Taxpayer to its healthcare professionals who are concurrently employed by the University is deemed to have been actually disbursed by University as a common paymaster. You have also requested a ruling that Taxpayer is an instrumentality of State X for purposes of sections 3306(c)(7) and 3121(b)(7) of the Code.

FACTS

Taxpayer is a medical practice plan incorporated in State X and organized by the University under State X law for the purpose of providing clinical instruction to medical students engaged in the formal study of medicine. Taxpayer received a letter from the Service recognizing that it is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3) and also stating that it is not a private foundation within the meaning of section 509(a).

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Taxpayer was formed for the following purposes:

To engage exclusively in charitable, educational, and scientific activities in which non-profit corporations in the [State X] may be involved, including specifically to:

Carry out, improve, enhance and supplement the medical educational activities and services of the [College of Medicine],

Enhance, improve and support the research and clinical service programs of the College of Medicine and the physicians who render clinical services in connection with their teaching duties, and

Provide medical care to all the sick and injured who may come to the College of Medicine faculty for diagnosis, treatment and care, without regard to race, color, creed, sex, age, or ability to pay and particularly to provide such medical care for persons who may seek such care at the [University] Hospitals.

Statute A gives the governor of State X the power to appoint members of the Board of Trustees of the University, with the advice and consent of the senate. Statute B grants the Board of Trustees general supervision over all property belonging to the University. Statute C grants the Board of Trustees the power to establish a College of Medicine.

The Board of Trustees adopted the Plan, a medical practice plan. The Plan provides that the College of Medicine's goal is to improve and maintain human health through education research, service and patient care. The Plan lays out policies, rules and procedures for the management and use of practice income from patient care.

The authority of the Taxpayer is vested in and exercised by or under the direction of a Board of Directors, who must operate within the Plan. The directors of the board are the Senior Vice President for Health Sciences/Dean (who is appointed by the University Board of Trustees), the Chairperson of each clinical department of the College of Medicine, three at large faculty of the College of Medicine, a community member and two ex-officio members: the Vice President for Health Services and Executive Director/Chief Operating Officer of the Taxpayer.

The College of Medicine has several departmental practice groups, each of which collects fees, pays patient care expenses, and distributes all practice income. Each departmental practice group will be reorganized as a limited liability company (LLC) with Taxpayer as its sole member. Each LLC will transfer the above-mentioned functions to the Taxpayer. You have represented that the LLC's will not elect to be classified as associations and will therefore be disregarded as entities separate from their owner pursuant to the default classification under regulations section 301.7701-3(b)(ii).

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Physicians and healthcare professionals will provide services through the LLCs. The Taxpayer's employees are limited to physicians or healthcare professionals who have faculty appointments in the College of Medicine and who have an employment agreement with the Taxpayer. More than 30 percent of the Taxpayer's employees will be concurrently employed by the College of Medicine and Taxpayer. Each of the employees of the Taxpayer will be qualified participants in State X's retirement system.

Income generated by the LLCs will fund the Taxpayer. Upon dissolution of the Taxpayer, all assets revert back to the College of Medicine and its assets must be contributed to a section 501(c)(3) organization with similar purposes.

LAW AND ANALYSIS

Common Paymaster

Section 3121(s) of the Code provides that, for purposes of sections 3102, 3111, and 3121(a)(1) of the Code, if two or more related corporations concurrently employ the same individual and compensate that individual through a common paymaster that is one of the corporations, each corporation shall not be considered to have paid as remuneration to the individual amounts actually disbursed to the individual by another of the corporations.

Section 3121(s) was amended by section 125 of Public Law 98-21, effective for wages paid after December 31, 1983, with respect to treatment of certain faculty practice plans. Section 125 provides that the following entities shall be deemed to be related corporations:

- (A) a state university that employs health professionals as faculty members at a medical school, and
- (B) a faculty practice plan described in section 501(c)(3) of the Code and exempt from tax under section 501(a) of the Code (i) that employs faculty members of such medical school, and (ii) 30 percent or more of the employees of which are concurrently employed by the medical school.

Section 125(a)(2) of P.L. 98-21 provides that remuneration that is disbursed by the faculty practice plan to a health professional employed by both entities shall be deemed to have been actually disbursed by the university as a common paymaster and not to have been actually disbursed by the faculty practice plan.

Thus, if a university and a faculty practice plan meet the requirements of section 125, all remuneration disbursed by the plan to health professionals employed by both entities is treated as disbursed by the university as a common paymaster. All other remuneration disbursed by the plan is treated as disbursed by the plan. Section

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3121(s) of the Code, as modified by section 125, relieves faculty practice plans of their obligation to withhold the employee portion of the FICA tax under section 3102 and of their obligation to pay the employer portion of FICA tax under section 3111 on remuneration paid to health professionals. Section 3121(s) also aggregates the remuneration paid to an employee by concurrent employers for purposes of determining the FICA wage base under section 3121(a)(1).

You have represented that Taxpayer is a faculty practice plan of the College of Medicine, which is part of the State University of State X. Taxpayer's physician-employees are faculty members at the College of Medicine, and more than 30 percent of Taxpayer's employees are concurrently employed by the College of Medicine.

On the basis of your representations, we conclude that Taxpayer and the College of Medicine satisfy the requirements of section 3121(s), as amended.

Instrumentality

Sections 3101 and 3111 of the Code impose FICA taxes on the wages paid by employers to employees with respect to employment. Sections 3101(a) and 3111(a) impose Old-Age, Survivors, and Disability Insurance (OASDI) taxes on the wages of employees. Sections 3101(b) and 3111(b) impose Hospital Insurance (HI) taxes on the wages of employees.

Section 3121(b)(7) provides that, for purposes of the FICA tax, "employment" does not include service performed in the employ of a state, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing that is wholly-owned thereby. Section 3121(b)(7)(F) of the Code and section 31.3121(b)(7)-2(c)(1) of the Treasury Regulations provide that this exception does not apply to services performed after July 1, 1991, if the employee is not a "qualified participant" in a retirement system of the state, political subdivision, or instrumentality.

Section 3121(u)(2) of the Code provides that, for services performed after March 31, 1986, section 3121(b)(7) does not relieve state and local government employers and employees of liability for the HI portion of the FICA tax imposed by sections 3101(b) and 3111(b) of the Code.

Section 3306(c)(8) of the Code provides that, for purposes of the FUTA tax, "employment" does not include service performed in the employ of an organization described in section 501(c)(3) and exempt from income tax under section 501(a).

Section 3306(c)(7) of the Code provides that, for purposes of the FUTA tax, "employment" does not include service performed in the employ of a state, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned by one or more states or political subdivisions.

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Accordingly, if an organization is a wholly-owned instrumentality of a state or political subdivision thereof, that organization is not required to pay FUTA tax. If that organization also maintains a retirement system, any wages paid to "qualified participants" in the retirement system, as defined in section 31.3121(b)(7)-2 of the regulations, are not subject to the OASDI portion of FICA taxes.

The following six factors are considered in determining whether an organization is an instrumentality of one or more states or political subdivisions: (1) whether it is used for a governmental purpose and performs a governmental function; (2) whether performance of its function is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner; (4) whether control and supervision of the organization is vested in public authority or authorities; (5) if express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and (6) the degree of financial autonomy and the source of its operating expenses. See Rev. Rul. 57-128, 1957-1 C.B. 311.

Taxpayer satisfies the first factor of Rev. Rul. 57-128 insofar as it has a governmental purpose and performs a legitimate governmental function. Taxpayer carries out, improves, enhances and supplements the educational purpose of the College of Medicine by performing the governmental function of educating medical students through clinical instruction and research activities.

Taxpayer also satisfies the second factor, performance of functions on behalf of the state. Taxpayer was created by the College of Medicine, a part of the State University of State X. Taxpayer was organized to perform an ancillary function for the Medical School at a university operated hospital.

Taxpayer also satisfies the third factor. Taxpayer represents that no private interests are involved and that State X has the interests and powers of an owner through the University, an instrumentality of State X. There are no private interests in the Taxpayer and Taxpayer's assets are required to be used exclusively for charitable purposes. On dissolution of the Taxpayer, its assets would be distributed to a similar section 501(c)(3) organization of the College of Medicine.

The fourth factor in Rev. Rul. 57-128 requires control to be vested in public authority or authorities. Statute A gives the governor of state X the power to appoint members of the Board of Trustees of the University, with the advice and consent of the senate. Statute C grants the Board of Trustees the power to establish a College of Medicine. The Board of Trustees adopted the Plan. The authority of the Taxpayer is vested in the Board of Directors of the Taxpayer, who must operate within the Plan. The board is subject to a full audit at least annually by the Dean of the Medical School, who is appointed by the University Trustees. Taxpayer is indirectly controlled by the Board of

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Trustees of the University and directly controlled by the Dean of the College of Medicine through authority vested in the Dean by the Plan. Taxpayer meets the fourth factor.

The fifth factor in Rev. Rul. 57-128 requires that express or implied statutory authority be necessary for the creation and use of Taxpayer. Taxpayer was created to further the educational purpose of the College of Medicine, part of University. Statute C grants the Board of Trustees the authority to create, provide for, and maintain a College of Medicine. Therefore, the fifth factor is satisfied.

The sixth and final factor in Rev. Rul. 57-128, which considers the degree of financial autonomy and the source of its operating expenses, is also satisfied. Taxpayer is funded by income generated by the LLCs through the provision of medical services to the community. The source of the Taxpayer's operating expenses will be the costs associated with administering and running the LLC's, and a pro rata share of these expenses will be billed to each LLC. The College of Medicine, through the Plan, strictly monitors Taxpayer's finances and the Taxpayer is subject to a full audit by the Dean of the College of Medicine at least annually. Each LLC must submit a full audit report annually to the University Medicine Research and Development Committee. Additionally, each LLC will be required to provide a percentage of gross collections to the College of Medicine in order to enhance teaching and research and provide for related capital needs.

Based solely on the information submitted, we rule as follows:

1. Taxpayer and the College of Medicine meet the requirements of section 3121(s) of the Code, as amended, and are related corporations under section 3121(s), as modified by section 125 of Public Law 98-21.
2. Taxpayer has satisfied all of the factors listed in Rev. Rul. 57-128. Accordingly, we conclude that Taxpayer is an instrumentality of State X for purposes of sections 3306(c)(7) and 3121(b)(7) of the Code. Therefore, wages paid to an employee of Taxpayer are not subject to FUTA taxes. Furthermore, the wages were not subject to the OASDI portion of the FICA tax for services performed prior to July 2, 1991. For periods after July 1, 1991, wages paid to an employee of Taxpayer are subject to the OASDI portion of the FICA tax unless the employee is a qualified participant in a retirement system described in section 31.3121(b)(7)-2(e) of the regulations.
3. Wages paid to Taxpayer's employees are subject to the HI tax unless they qualify for the continuing employment exception under section 3121(u)(2)(C) of the Code. No opinion is expressed as to whether any employees of Taxpayer qualify for this exception.

No opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. The above analysis is based

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on the assumption that the Taxpayer is not covered by a section 218 agreement. We do not express an opinion as to whether the Taxpayer and the University are an affiliated service group under section 414(m) or whether the Taxpayer's plan is a governmental plan under section 414(d).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Lynne Camillo
Chief, Employment Tax Branch 2
Office of the Assistant Chief Counsel
(Exempt Organizations / Employment Tax/
Government Entities)