



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D. C. 20224

OFFICE OF THE CHIEF COUNSEL

January 31, 2012

Number: **2012-0016**
Release Date: 3/30/2012

CC:TEGE:EOEG:ET2
GENIN-149020-11

UIL: 3121.05-00, 6413.02-00

Dear :

This letter responds to your request for information dated November 17, 2011. You requested information concerning the Federal Insurance Contributions Act (FICA) tax treatment of wages paid to prisoners in a prison industry program and the refund of erroneously paid FICA taxes.

Whether the wages paid to prison inmates for services they provide are subject to FICA taxes depends on whether an employer-employee relationship exists between the inmates and the entity for which they provide services. In addition, even if an employer-employee relationship exists, the law exempts wages from certain types of employers (e.g., state and local governments) from FICA tax. Finally, the Internal Revenue Code ("Code") establishes a period of limitations for claiming a credit or refund of overpaid FICA taxes.

Employer-Employee Relationship

FICA taxes consist of the old-age, survivors, and disability (social security tax) portion and the hospital insurance portion (Medicare tax) and are computed as a percentage of wages paid by the employer and received by the employee for employment. [Sections 3101, 3111, 3121 of the Code]. Generally, all remuneration an employer pays for services an employee performs is subject to FICA taxes unless the law specifically excepts the remuneration from the term "wages" or excepts the services from the term "employment." [Sections 3101, 3111, and 3121 of the Code]. An employer-employee relationship exists when the person for whom the individual performs services has the right to control and direct that individual 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. [Treasury Regulation § 31.3121(d)-1(c)(2)].

Not every situation involving control over a worker necessarily results in the creation of an employee-employer relationship. Thus, Revenue Ruling 75-325, 1975-2 C.B. 415 concluded that federal prison inmates who were paid for services they provided through a prison inmate work program were not employees because the relationship between the inmates and the federal labor program arose from incarceration together with the legal duty of the program to provide rehabilitative labor. Since no employer-employee relationship existed in this type of prison labor program, the payments made to inmates were not subject to employment taxes.

However, whether an employer-employee relationship exists depends on the facts and circumstances of the work arrangement. Thus, a prison inmate work program that is designed to create an actual employment relationship may be distinguishable from the program described in Rev. Rul. 75-325. For example, an employer-employee relationship may exist in situations where inmates participate voluntarily in the work program, are paid prevailing wages, the program is designed to provide as realistic a working environment as possible within a prison, private businesses assume responsibility for the direction and control of workers, and the inmate workers have rights to participate in benefits made available by the federal or state government to other individuals on the basis of their employment.

State Entity as Employer

Even if an employer-employee relationship exists, wages paid to prison inmates may not be subject to FICA taxes if the employer is a state or local government entity. The law excepts services performed by prison inmates in the employ of a State, political subdivision, or wholly owned instrumentality thereof from employment for purposes of social security tax. [Section 3121(b)(7)(F) of the Code]. The law also excepts such wages from the Medicare tax. [Section 3121(u)(2)(B)(ii)(II) of the Code].

This exception does not apply, however, if the inmate is performing services in the employ of a nongovernmental entity (for example, a private corporation operating a prison). Thus, whether amounts paid to a prison inmate are subject to FICA depends upon whether an employer-employee relationship exists and whether the inmate is employed by a government or a private employer.

Refund of FICA Tax

In general, taxpayers must file claims for credit or refund within 3 years from the time they file the return, or 2 years from the time they pay the tax, whichever date is later. [Section 6511(a) of the Code]. For purposes of FICA tax refunds, the relevant return is the employer's Form 941. The law deems Forms 941 that a taxpayer filed for any period ending with or within a calendar year which are filed before April 15 of the succeeding calendar year as filed on April 15 of such succeeding calendar year. Likewise, the law deems any FICA tax a taxpayer paid during such period as paid on April 15 of such succeeding calendar year. [Section 6513(c) of the Code].

Taxpayers cannot receive refunds after the expiration of the period of limitations unless they have timely filed a claim for credit or refund before the expiration of the period of limitations [Treasury Regulation section 301.6402-2(a)(1)].

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2012-1, §2.04, 2012-1 IRB 1. If you have any additional questions, please contact

. He can be reached at

Sincerely,

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Counsel
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