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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 31

TD 9167

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Student FICA Exception

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulation

SUMMARY: This document contains final regulations providing guidance regarding the employment tax exceptions for student services. These regulations affect schools, colleges, and universities and their employees.

DATES: Effective date: December 21, 2004.

Applicability date: These regulations are applicable for services performed on or after April 1, 2005.

FOR FURTHER INFORMATION CONTACT: John Richards of the Office of Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622-6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains amendments to 26 CFR part 31 under sections 3121(b)(10) and 3306(c)(10)(B) of the Internal Revenue Code (Code). These sections except from "employment" for Federal Insurance Contributions Act (FICA) and Federal

Unemployment Tax Act (FUTA) purposes, respectively, service performed in the employ of a school, college, or university by a student who is enrolled and regularly attending classes at such school, college, or university. In addition, this document contains amendments to 26 CFR part 31 under section 3121(b)(2). This section excepts from employment for FICA purposes domestic service performed in a local college club, or local chapter of a college fraternity or sorority, by a student who is enrolled and is regularly attending cases at a school, college, or university.

Proposed regulations under sections 3121(b)(2), 3121(b)(10), and 3306(c)(10)(B) were published in the **Federal Register** on February 25, 2004 (69 FR 8604, 2004-10 I.R.B. 571). Written and electronic comments responding to the notice of proposed rulemaking were received. A public hearing was held on June 16, 2004. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

### **Explanation of Provisions and Summary of Comments**

The final regulations provide rules for determining whether an organization is a school, college, or university (SCU) and whether an employee is a student for purposes of sections 3121(b)(10), 3121(b)(2), and 3306(c)(10)(B) of the Code. Many comments were received on the proposed regulations and several witnesses testified at the hearing which was held June 16, 2004. After consideration of the comments and testimony, the Treasury department and the IRS decided to make several significant changes described below.

#### 1. School, College, or University

The exceptions from employment for student services apply only if the employee is a student enrolled and regularly attending classes at a SCU. Under the proposed regulations, whether an organization is a SCU is determined with reference to the organization's primary function. An organization whose primary function is to carry on educational activities qualifies as a SCU for purposes of the student exceptions from employment.

A few commentators suggested that an organization, such as a teaching hospital, that has embedded within it a division or function that carries on educational activities should be treated as a SCU for purposes of the student exceptions from employment.

The final regulations retain the primary function standard as described in the proposed regulations. As discussed in the preamble to the proposed regulations, the primary function standard is based upon the existing statutory and regulatory language under section 3121(b)(10), as well as the legislative history relating to the student exception from employment under section 3121(b)(10).

## 2. Enrolled and Regularly Attending Classes

The exceptions from employment for student services require that an employee be "enrolled and regularly attending classes" in order to have the status of a student. Under the proposed regulations, "a class is an instructional activity led by a knowledgeable faculty member for identified students following an established curriculum."

Commentators requested clarification regarding whether an instructional activity must be led by a regular faculty member in order to be considered a class, or whether

an activity led by an adjunct faculty member, graduate teaching assistant, or other qualified individual hired to lead the activity could be considered a class.

The final regulations clarify that a class is an instructional activity led by a faculty member “or other qualified individual” following an established curriculum. Thus, an instructional activity led by an adjunct faculty member, graduate assistant, or other qualified individual can qualify as a class for purposes of the student exceptions from employment.

### 3. Student Status

The existing student FICA regulations provide that an employee whose services are incident to and for the purpose of pursuing a course of study has the status of a student. §31.3121(b)(10)-2(c). The proposed regulations provide that in order for an employee’s services to be considered incident to and for the purpose of pursuing a course of study, the educational aspect of the relationship between the employee and the employer, as compared to the service aspect, must be predominant. Under the proposed regulations, if an employee is a “career employee,” then the service aspect of the employee’s relationship with the employer is considered predominant, and thus the employee’s services are not considered incident to and for the purpose of pursuing a course of study. The proposed regulations provide that the following employees are considered career employees: (1) employees who regularly perform services 40 hours or more per week; (2) professional employees; (3) employees who receive certain employment benefits; and (4) employees required to be licensed to work in the field in which the employees are performing services. The IRS requested comments on the criteria used to identify employees having the status of a career employee.

Commentators expressed concern about using these criteria to make certain employees automatically ineligible for the student FICA exception. Rather, according to commentators, whether an employee's services are incident to and for the purpose of pursuing a course of study should be based upon all the relevant facts and circumstances.

The final regulations provide that the educational and service aspects of an employee's relationship with the employer are generally evaluated for an academic term based upon all the relevant facts and circumstances. Similar criteria to those identified in the proposed regulations are described in the final regulations as relevant factors, not dispositive criteria, in determining whether the educational or service aspect of an employee's relationship with the employer is predominant. Nevertheless, under the final regulations, if an employee is a "full-time employee," then the employee's services are not incident to and for the purpose of pursuing a course of study. In addition, based upon comments received, the criteria identified in the proposed regulations have been modified as described below.

#### A. Full-Time Employee and Hours Worked

The proposed regulations provide that an employee who "regularly performs services 40 hours or more per week" is a career employee, and is thus ineligible for the student exception from employment. Commentators expressed concern that the 40 hour criterion would be administratively impracticable because it would be difficult to monitor an employee's actual hours worked during an academic term. In addition, commentators expressed concern that the meaning of "regularly" is unclear, making it difficult to assess the effect of changes in hours worked from week to week.

Commentators also requested clarification on whether an employee's number of hours worked during academic breaks is considered in determining whether the employee is eligible for the student FICA exception.

The final regulations modify the hours worked criterion. The final regulations provide that the services of a "full-time employee" are not incident to and for the purpose of pursuing a course of study. Under the final regulations, a full-time employee is an employee who is considered a full-time employee based upon the employer's standards and practices, except that an employee whose "normal work schedule is 40 hours or more per week" is considered a full-time employee. This standard is intended to improve administrability for employers. Whether an employee is a full-time employee based upon the employer's standards and practices, or based upon the employee's normal work schedule, should be determinable by employers at the start of an academic term, thus reducing instances where an employee's status shifts from student to non-student during an academic term. An employee's normal work schedule does not change, for example, based upon changes in work demands that are unforeseen at the start of an academic term causing the employee to work additional hours beyond his normal work schedule. In addition, time spent performing services that have an educational or instructional aspect is considered in determining an employee's normal work schedule. Finally, the final regulations provide that an employee's work schedule during an academic break is not considered in determining whether the employee's normal work schedule is 40 hours or more per week.

The final regulations provide that if an employee does not have the status of a full-time employee, then the employee's normal work schedule and actual number of

hours worked per week are relevant factors in determining whether the service aspect or educational aspect of the employee's relationship with the employer is predominant. Thus, if an employee is normally scheduled to work 20 hours per week, but consistently works more than 40 hours per week, the amount of time actually worked is taken into account in determining whether or not the employee qualifies as a student.

## B. Professional Employee and Licensure

### 1. Professional Employee

The proposed regulations provide that a "professional employee" is a career employee, and is thus ineligible for the student exception from employment. Under the proposed regulations, a professional employee is an employee who performs work: (1) requiring knowledge of an advanced type in a field of science or learning, (2) requiring the consistent exercise of discretion and judgment, and (3) that is predominantly intellectual and varied in character.

Commentators expressed concern that the professional employee criterion would inappropriately disqualify the services of many graduate research and teaching assistants from eligibility for the student exceptions from employment. Commentators maintained that graduate research and teaching assistants are primarily students, and thus their services should not automatically be ineligible for the student exceptions based upon the professional employee criterion.

The final regulations provide that whether an employee is a professional employee is a relevant factor, not a dispositive criterion, in evaluating the service aspect of the employee's relationship with the employer. Under the final regulations, 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. Whether a professional employee is a student will depend upon all the facts and circumstances. Thus, under the final regulations, those graduate assistants and other employees whose work is described under the professional employee standard are not automatically ineligible for the student exception.

## 2. Licensure

The proposed regulations provide that an employee who is required to be licensed under state or local law to work in the field in which the employee performs services is a career employee, and is thus ineligible for the student exception. The preamble to the proposed regulations requested comments on the licensure criterion and whether this criterion should be further refined or clarified.

Commentators expressed concern that the licensure criterion under the proposed regulations is overly broad because it would cause employees licensed for health and safety reasons, such as van drivers and life guards, to be ineligible for student status.

Under the final regulations, an employee's licensure status is not a dispositive criterion. Instead, the final regulations provide if an employee is a professional employee, then whether the employee is licensed is a relevant factor in determining whether the service aspect of the employee's relationship with the employer is predominant. The final regulations provide that if an employee has the status of a licensed, professional employee, then that fact further suggests that the service aspect of the employee's relationship with the employer is predominant. However, a worker

who is a licensed, professional employee could be considered a student based upon all the relevant facts and circumstances.

### C. Employment Benefits

The proposed regulations provide that an employee who is eligible to receive certain employment benefits is considered a career employee, and is thus ineligible for the student exception.

Commentators expressed concern that eligibility to receive employment benefits should not disqualify an individual from the student exception. Commentators noted that some state statutes make student employees eligible for retirement and other benefits, meaning that student employees in those states could not qualify as students under the proposed regulations. In addition, commentators noted that many colleges and universities permit student employees to make elective contributions to section 403(b) arrangements. Under the proposed regulations, offering this benefit would prohibit student employees from qualifying as students for purposes of the student exceptions from employment.

The final regulations provide that eligibility to receive employment benefits is a relevant factor, not a dispositive criterion, in determining whether the service aspect of an employee's relationship with the employer is predominant. Thus, an employee who is eligible for employment benefits can still qualify as a student for purposes of the student exceptions from employment. In addition, the final regulations provide that eligibility to receive health insurance benefits is not considered in determining whether the service aspect is predominant, and eligibility for benefits mandated by state or local law is given less weight in determining whether the service aspect is predominant.

#### 4. Effective Date

Commentators objected to the proposed effective date of February 25, 2004, asserting that it would take some time to adjust to the new rules set forth in the proposed regulations. In response to these comments, the final regulations are applicable with respect to services performed on or after April 1, 2005.

#### 5. Revenue Procedure Replacing Rev. Proc. 98-16

When the IRS issued the proposed regulations, it also issued Notice 2004-12 (2004-10 I.R.B. 556) suspending Rev. Proc. 98-16 (1998-1 C.B. 403) and proposing to replace it with a revenue procedure that is consistent with the proposed regulations. The IRS solicited comments on the proposed revenue procedure. Comments were received and considered in conjunction with the comments on the proposed regulations. The proposed revenue procedure has been modified in response to comments, and in order to provide guidance that is consistent with the final regulations, is being issued in final form in Rev. Proc. 2005-11 (to be published in I.R.B. 2005-2) modifying and superseding Rev. Proc. 98-16. Rev. Proc. 2005-11 is applicable with respect to services performed on or after April 1, 2005. Taxpayers may rely upon Rev. Proc. 98-16 with respect to services performed prior to April 1, 2005.

#### **Special Analyses**

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. In addition, because no collection of information is imposed on small entities, the

provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small business.

### **Drafting Information**

The principal author of these proposed regulations is John Richards of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 31**

Employment taxes and collection of income tax at source.

### **Adoption of Amendment to the Regulations**

Accordingly, 26 CFR part 31 is amended as follows:

#### **Part 31--EMPLOYMENT TAXES**

Paragraph 1. The authority citation for part 31 continues to read in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. In § 31.3121(b)(2)-1, paragraph (d) is revised to read as follows:

§ 31.3121(b)(2)-1 Domestic service performed by students for certain college organizations.

\* \* \* \* \*

(d) An organization is a school, college, or university within the meaning of section 3121(b)(2) 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. See section 170(b)(1)(A)(ii) and the regulations thereunder.

\* \* \* \* \*

Par. 3. Section 31.3121(b)(10)-2 is amended by:

1. Revising paragraphs (a), (b), (c) and (d).
2. Redesignating paragraph (e) as (g).
3. Adding paragraphs (e) and (f).

The revisions and additions read as follows:

§ 31.3121(b)(10)-2 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.

(a) General rule. (1) Services performed in the employ of a school, college, or university within the meaning of paragraph (c) of this section (whether or not the organization is exempt from income tax) are excepted from employment, if the services are performed by a student within the meaning of paragraph (d) of this section who is enrolled and is regularly attending classes at the school, college, or university.

(2) Services performed in the employ of an organization which is--

- (i) Described in section 509(a)(3) and §1.509(a)-4;

(ii) Organized, and at all times thereafter operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of a school, college, or university within the meaning of paragraph (c) of this section; and

(iii) Operated, supervised, or controlled by or in connection with the school, college, or university; are excepted from employment, if the services are performed by a student who is enrolled and regularly attending classes within the meaning of paragraph (d) of this section at the school, college, or university. The preceding sentence shall not apply to services performed in the employ of a school, college, or university of a State or a political subdivision thereof by a student referred to in section 218(c)(5) of the Social Security Act (42 U.S.C. 418(c)(5)) if such services are covered under the agreement between the Commissioner of Social Security and such State entered into pursuant to section 218 of such Act. For the definitions of "operated, supervised, or controlled by", "supervised or controlled in connection with", and "operated in connection with", see paragraphs (g), (h), and (i), respectively, of §1.509(a)-4.

(b) Statutory tests. For purposes of this section, if an employee has the status of a student within the meaning of paragraph (d) of this section, 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 not material.

The statutory tests are:

(1) The character of the organization in the employ of which the services are performed as a school, college, or university within the meaning of paragraph (c) of this section, or as an organization described in paragraph (a)(2) of this section, and

(2) The status of the employee as a student enrolled and regularly attending classes within the meaning of paragraph (d) of this section at the school, college, or university within the meaning of paragraph (c) of this section by which the employee is employed or with which the employee's employer is affiliated within the meaning of paragraph (a)(2) of this section.

(c) School, College, or University. An organization is a school, college, or university within the meaning of section 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. See section 170(b)(1)(A)(ii) and the regulations thereunder.

(d) Student Status--general rule. Whether an employee has the status of a student performing the services shall be determined based on the relationship of the employee with the organization employing the employee. In order to have the status of a student, the employee must perform services in the employ of a school, college, or university within the meaning of paragraph (c) of this section at which the employee is enrolled and regularly attending classes in pursuit of a course of study within the meaning of paragraphs (d)(1) and (2) of this section. In addition, the employee's services must be incident to and for the purpose of pursuing a course of study within the meaning of paragraph (d)(3) of this section at such school, college, or university. An employee who performs services in the employ of an affiliated organization within the meaning of paragraph (a)(2) of this section must be enrolled and regularly attending classes at the affiliated school, college, or university within the meaning of paragraph

(c) of this section in pursuit of a course of study within the meaning of paragraphs (d)(1) and (2) of this section. In addition, the employee's services must be incident to and for the purpose of pursuing a course of study within the meaning of paragraph (d)(3) of this section at such school, college, or university.

(1) Enrolled and regularly attending classes. An employee must be enrolled and regularly attending classes at a school, college, or university within the meaning of paragraph (c) of this section at which the employee is employed to have the status of a student within the meaning of section 3121(b)(10). An employee is enrolled within the meaning of section 3121(b)(10) if the employee is registered for a course or courses creditable toward an educational credential described in paragraph (d)(2) of this section. In addition, the employee must be regularly attending classes to have the status of a student. For purposes of this paragraph (d)(1), a class is an instructional activity led by a faculty member or other qualified individual hired by the school, college, or university within the meaning of paragraph (c) of this section for identified students following an established curriculum. Traditional classroom activities are not the sole means of satisfying this requirement. For example, research activities under the supervision of a faculty advisor necessary to complete the requirements for a Ph.D. degree may constitute classes within the meaning of section 3121(b)(10). The frequency of these and similar activities determines whether an employee may be considered to be regularly attending classes.

(2) Course of study. An employee must be pursuing a course of study in order to have the status of a student. A course of study is one or more courses the completion of which fulfills the requirements necessary to receive an educational credential granted

by a school, college, or university within the meaning of paragraph (c) of this section. For purposes of this paragraph, an educational credential is a degree, certificate, or other recognized educational credential granted by an organization described in paragraph (c) of this section. A course of study also includes one or more courses at a school, college or university within the meaning of paragraph (c) of this section the completion of which fulfills the requirements necessary for the employee to sit for an examination required to receive certification by a recognized organization in a field.

(3) Incident to and for the purpose of pursuing a course of study. (i) General rule. An employee's services must be incident to and for the purpose of pursuing a course of study in order for the employee to have the status of a student. Whether an employee's services are incident to and for the purpose of pursuing a course of study shall be 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 between the employer and the employee, as compared to the service aspect of the relationship, must be predominant in order for the employee's services to be incident to and for the purpose of pursuing a course of study. The educational aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The service aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the employee's employment. The evaluation of the service aspect of the relationship is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect. Except as provided in paragraph (d)(3)(iii) of this section, whether the educational aspect or the service aspect of an

employee's relationship with the employer is predominant is determined by considering all the relevant facts and circumstances. Relevant factors in evaluating the educational and service aspects of an employee's relationship with the employer are described in paragraphs (d)(3)(iv) and (v) of this section respectively. There may be facts and circumstances that are relevant in evaluating the educational and service aspects of the relationship in addition to those described in paragraphs (d)(3)(iv) and (v) of this section.

(ii) Student status determined with respect to each academic term. 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. If the relevant facts and circumstances with respect to an employee's relationship with the employer change significantly during an academic term, whether the employee's services are incident to and for the purpose of pursuing a course of study is reevaluated with respect to services performed during the remainder of the academic term.

(iii) Full-time employee. 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. An employee's normal work schedule is not affected by increases in hours worked caused by work demands unforeseen at the start of an academic term. However, whether an employee is a full-time employee is reevaluated for the remainder of the academic term if the employee changes employment positions with the employer. An

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. The determination of an employee's normal work schedule is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect.

(iv) Evaluating educational aspect. The educational aspect of an employee's relationship with the employer is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. 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 school, college or university within the meaning of paragraph (c) of this section at which the employee is enrolled and regularly attending classes.

(v) Evaluating service aspect. The service aspect of an employee's relationship with the employer is evaluated based on the facts and circumstances related to the employee's employment. Services of an employee with the status of a full-time employee within the meaning of paragraph (d)(3)(iii) of this section are not incident to and for the purpose of pursuing a course of study. Relevant factors in evaluating the service aspect of an employee's relationship with the employer are described in paragraphs (d)(3)(v)(A), (B), and (C) of this section.

(A) Normal work schedule and hours worked. If an employee is not a full-time employee within the meaning of paragraph (d)(3)(iii) of this section, then the employee's normal work schedule and number of hours worked per week are relevant factors in evaluating the service aspect of the employee's relationship with the employer. As an employee's normal work schedule or actual number of hours worked approaches 40 hours per week, it is more likely that the service aspect of the employee's relationship with the employer is predominant. The determination of an employee's normal work schedule and actual number of hours worked is not affected by the fact that some of the services performed by the employee may have an educational, instructional, or training aspect.

(B) Professional employee.

(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--

(i) 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;

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

(iii) 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.

(2) Licensed, professional employee. If an employee is a licensed, professional employee, then that further suggests the service aspect of the employee's relationship with the employer is predominant. An employee is a licensed, professional employee if the employee is required to be licensed under state or local law to work in the field in which the employee performs services and the employee is a professional employee within the meaning of paragraph (d)(3)(v)(B)(1) of this section.

(C) Employment Benefits. Whether an employee is eligible to receive one or more employment benefits is a relevant factor in evaluating the service aspect of an employee's relationship with the employer. For example, eligibility to receive vacation, paid holiday, and paid sick leave benefits; eligibility to participate in a retirement plan or arrangement described in sections 401(a), 403(b), or 457(a); or eligibility to receive employment benefits such as reduced tuition (other than qualified tuition reduction under section 117(d)(5) provided to a teaching or research assistant who is a graduate student), or benefits under sections 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), or 137 (adoption assistance) suggest that the service aspect of an employee's relationship with the employer is predominant. Eligibility to receive health insurance employment benefits is not considered in determining whether the service aspect of an employee's relationship with the employer is predominant. The weight to be given the fact that an employee is

eligible for a particular employment benefit may vary depending on the type of benefit. For example, eligibility to participate in a retirement plan is generally more significant than eligibility to receive a dependent care employment benefit. Additional weight is given to the fact that an employee is eligible to receive an employment benefit if the benefit is generally provided by the employer to employees in positions generally held by non-students. Less weight is given to the fact that an employee is eligible to receive an employment benefit if eligibility for the benefit is mandated by state or local law.

(e) Examples. The following examples illustrate the principles of paragraphs (a) through (d) of this section:

Example 1. (i) Employee C is employed by State University T to provide services as a clerk in T's administrative offices, and is enrolled and regularly attending classes at T in pursuit of a B.S. degree in biology. C has a course workload during the academic term which constitutes a full-time course workload at T. C is considered a part-time employee by T during the academic term, and C's normal work schedule is 20 hours per week, but occasionally due to work demands unforeseen at the start of the academic term C works 40 hours or more during a week. C is compensated by hourly wages, and receives no other compensation or employment benefits.

(ii) In this example, C is employed by T, a school, college, or university within the meaning of paragraph (c) of this section. C is enrolled and regularly attending classes at T in pursuit of a course of study. C is not a full-time employee based on T's standards, and C's normal work schedule does not cause C to have the status of a full-time employee, even though C may occasionally work 40 hours or more during a week due to unforeseen work demands. C's part-time employment relative to C's full-time course workload indicates that the educational aspect of C's relationship with T is predominant. Additional facts supporting this conclusion are that C is not a professional employee, and C does not receive any employment benefits. Thus, C's services are incident to and for the purpose of pursuing a course of study. Accordingly, C's services are excepted from employment under section 3121(b)(10).

Example 2. (i) Employee D is employed in the accounting department of University U, and is enrolled and regularly attending classes at U in pursuit of a n M.B.A. degree. D has a course workload which constitutes a half-time course workload at U. D is considered a full-time employee by U under U's standards and practices.

(ii) In this example, D is employed by U, a school, college, or university within the meaning of paragraph (c) of this section. In addition, D is enrolled and regularly

attending classes at U in pursuit of a course of study. However, because D is considered a full-time employee by U under its standards and practices, D's services are not incident to and for the purpose of pursuing a course of study. Accordingly, D's services are not excepted from employment under section 3121(b)(10).

Example 3. (i) The facts are the same as in Example 2, except that D is not considered a full-time employee by U, and D's normal work schedule is 32 hours per week. In addition, D's work is repetitive in nature and does not require the consistent exercise of discretion and judgment, and is not predominantly intellectual and varied in character. However, D receives vacation, sick leave, and paid holiday employment benefits, and D is eligible to participate in a retirement plan maintained by U described in section 401(a).

(ii) In this example, D's half-time course workload relative to D's hours worked and eligibility for employment benefits indicates that the service aspect of D's relationship with U is predominant, and thus D's services are not incident to and for the purpose of pursuing a course of study. Accordingly, D's services are not excepted from employment under section 3121(b)(10).

Example 4. (i) Employee E is employed by University V to provide patient care services at a teaching hospital that is an unincorporated division of V. These services are performed as part of a medical residency program in a medical specialty sponsored by V. The residency program in which E participates is accredited by the Accreditation Council for Graduate Medical Education. Upon completion of the program, E will receive a certificate of completion, and be eligible to sit for an examination required to be certified by a recognized organization in the medical specialty. E's normal work schedule, which includes services having an educational, instructional, or training aspect, is 40 hours or more per week.

(ii) In this example, E is employed by V, a school, college, or university within the meaning of paragraph (c) of this section. However, E's normal work schedule calls for E to perform services 40 or more hours per week. E is therefore a full-time employee, and the fact that some of E's services have an educational, instructional, or training aspect does not affect that conclusion. Thus, E's services are not incident to and for the purpose of pursuing a course of study. Accordingly, E's services are not excepted from employment under section 3121(b)(10) and there is no need to consider other relevant factors, such as whether E is a professional employee or whether E is eligible for employment benefits.

Example 5. (i) Employee F is employed in the facilities management department of University W. F has a B.S. degree in engineering, and is completing the work experience required to sit for an examination to become a professional engineer eligible for licensure under state or local law. F is not attending classes at W.

(ii) In this example, F is employed by W, a school, college, or university within the meaning of paragraph (c) of this section. However, F is not enrolled and regularly

attending classes at W in pursuit of a course of study. F's work experience required to sit for the examination is not a course of study for purposes of paragraph (d)(2) of this section. Accordingly, F's services are not excepted from employment under section 3121(b)(10).

Example 6. (i) Employee G is employed by Employer X as an apprentice in a skilled trade. X is a subcontractor providing services in the field in which G wishes to specialize. G is pursuing a certificate in the skilled trade from Community College C. G is performing services for X pursuant to an internship program sponsored by C under which its students gain experience, and receive credit toward a certificate in the trade.

(ii) In this example, G is employed by X. X is not a school, college or university within the meaning of paragraph (c) of this section. Thus, the exception from employment under section 3121(b)(10) is not available with respect to G's services for X.

Example 7. (i) Employee H is employed by a cosmetology school Y at which H is enrolled and regularly attending classes in pursuit of a certificate of completion. Y's primary function is to carry on educational activities to prepare its students to work in the field of cosmetology. Prior to issuing a certificate, Y requires that its students gain experience in cosmetology services by performing services for the general public on Y's premises. H is scheduled to work and in fact works significantly less than 30 hours per week. H's work does not require knowledge of an advanced type in a field of science or learning, nor is it predominantly intellectual and varied in character. H receives remuneration in the form of hourly compensation from Y for providing cosmetology services to clients of Y, and does not receive any other compensation and is not eligible for employment benefits provided by Y.

(ii) In this example, H is employed by Y, a school, college or university within the meaning of paragraph (c) of this section, and is enrolled and regularly attending classes at Y in pursuit of a course of study. Factors indicating the educational aspect of H's relationship with Y is predominant are that H's hours worked are significantly less than 30 per week, H is not a professional employee, and H is not eligible for employment benefits. Based on the relevant facts and circumstances, the educational aspect of H's relationship with Y is predominant. Thus, H's services are incident to and for the purpose of pursuing a course of study. Accordingly, H's services are excepted from employment under section 3121(b)(10).

Example 8. (i) Employee J is a graduate teaching assistant at University Z. J is enrolled and regularly attending classes at Z in pursuit of a graduate degree. J has a course workload which constitutes a full-time course workload at Z. J's normal work schedule is 20 hours per week, but occasionally due to work demands unforeseen at the start of the academic term J works more than 40 hours during a week. J's duties include grading quizzes and exams pursuant to guidelines set forth by the professor, providing class and laboratory instruction pursuant to a lesson plan developed by the professor, and preparing laboratory equipment for demonstrations. J receives a cash

stipend and employment benefits in the form of eligibility to make elective employee contributions to an arrangement described in section 403(b). In addition, J receives qualified tuition reduction benefits within the meaning of section 117(d)(5) with respect to the tuition charged for the credits earned for being a graduate teaching assistant.

(ii) In this example, J is employed by Z, a school, college, or university within the meaning of paragraph (c) of this section, and is enrolled and regularly attending classes at Z in pursuit of a course of study. J's full-time course workload relative to J's normal work schedule of 20 hours per week indicates that the educational aspect of J's relationship with Z is predominant. In addition, J is not a professional employee because J's work does not require the consistent exercise of discretion and judgment in its performance. On the other hand, the fact that J receives employment benefits in the form of eligibility to make elective employee contributions to an arrangement described in section 403(b) indicates that the employment aspect of J's relationship with Z is predominant. Balancing the relevant facts and circumstances, the educational aspect of J's relationship with Z is predominant. Thus, J's services are incident to and for the purpose of pursuing a course of study. Accordingly, J services are excepted from employment under section 3121(b)(10).

(f) Effective date. Paragraphs (a), (b), (c), (d) and (e) of this section apply to services performed on or after April 1, 2005.

\* \* \* \*

Par. 4. In §31.3306(c)(10)-2:

1. Paragraph (c) is revised.
2. Paragraphs (d) and (e) are added.

The revision and addition read as follows:

§ 31.3306(c)(10)-2 Services of student in employ of a school, college, or university.

\* \* \* \* \*

(c) General rule. (1) For purposes of this section, the tests are the character of the organization in the employ of which the services are performed and the status of the employee as a student enrolled and regularly attending classes at the school, college, or university described in paragraph (c)(2) of this section, in the employ of which the employee performs the services. If an employee has the status of a student within the

meaning of paragraph (d) of this section, the type of services performed by the employee, the place where the services are performed, and the amount of remuneration for services performed by the employee are not material.

(2) School, college, or university. An organization is a school, college, or university within the meaning of section 3306(c)(10)(B) 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. See section 170(b)(1)(A)(ii) and the regulations thereunder.

(d) Student Status --general rule. Whether an employee has the status of a student within the meaning of section 3306(c)(10)(B) performing the services shall be determined based on the relationship of the employee with the organization for which the services are performed. In order to have the status of a student within the meaning of section 3306(c)(10)(B), the employee must perform services in the employ of a school, college, or university described in paragraph (c)(2) of this section at which the employee is enrolled and regularly attending classes in pursuit of a course of study within the meaning of paragraphs (d)(1) and (2) of this section. In addition, the employee's services must be incident to and for the purpose of pursuing a course of study at such school, college, or university within the meaning of paragraph (d)(3) of this section.

(1) Enrolled and regularly attending classes. An employee must be enrolled and regularly attending classes at a school, college, or university within the meaning of paragraph (c)(2) of this section at which the employee is employed to have the status of

a student within the meaning of section 3306(c)(10)(B). An employee is enrolled within the meaning of section 3306(c)(10)(B) if the employee is registered for a course or courses creditable toward an educational credential described in paragraph (d)(2) of this section. In addition, the employee must be regularly attending classes to have the status of a student. For purposes of this paragraph (d)(1), a class is an instructional activity led by a faculty member or other qualified individual hired by the school, college, or university within the meaning of paragraph (c)(2) of this section for identified students following an established curriculum. The frequency of these and similar activities determines whether an employee may be considered to be regularly attending classes.

(2) Course of study. An employee must be pursuing a course of study in order to have the status of a student within the meaning of section 3306(c)(10)(B). A course of study is one or more courses the completion of which fulfills the requirements necessary to receive an educational credential granted by a school, college, or university within the meaning of paragraph (c)(2) of this section. For purposes of this paragraph, an educational credential is a degree, certificate, or other recognized educational credential granted by an organization described in paragraph (c)(2) of this section. In addition, a course of study is one or more courses at a school, college or university within the meaning of paragraph (c)(2) of this section the completion of which fulfills the requirements necessary for the employee to sit for an examination required to receive certification by a recognized organization in a field.

(3) Incident to and for the purpose of pursuing a course of study. (i) General rule. An employee's services must be incident to and for the purpose of pursuing a course of study in order for the employee to have the status of a student. Whether an

employee's services are incident to and for the purpose of pursuing a course of study shall be 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 between the employer and the employee, as compared to the service aspect of the relationship, must be predominant in order for the employee's services to be incident to and for the purpose of pursuing a course of study. The educational aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. The service aspect of the relationship is evaluated based on all the relevant facts and circumstances related to the employee's employment. The evaluation of the service aspect of the relationship is not affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect. Except as provided in paragraph (d)(3)(iii) of this section, whether the educational aspect or the service aspect of an employee's relationship with the employer is predominant is determined by considering all the relevant facts and circumstances. Relevant factors in evaluating the educational and service aspects of an employee's relationship with the employer are described in paragraphs (d)(3)(iv) and (v) of this section respectively. There may be facts and circumstances that are relevant in evaluating the educational and service aspects of the relationship in addition to those described in paragraphs (d)(3)(iv) and (v) of this section.

(ii) Student status determined with respect to each academic term. 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. If the relevant facts and

circumstances with respect to an employee's relationship with the employer change significantly during an academic term, whether the employee's services are incident to and for the purpose of pursuing a course of study is reevaluated with respect to services performed during the remainder of the academic term.

(iii) Full-time employee. 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. An employee's normal work schedule is not affected by increases in hours worked caused by work demands unforeseen at the start of an academic term. However, whether an employee is a full-time employee is reevaluated for the remainder of the academic term if the employee changes employment positions with the employer. An 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. The determination of the employee's normal work schedule is not affected by the fact that the services performed by the individual may have an educational, instructional, or training aspect.

(iv) Evaluating educational aspect. The educational aspect of an employee's relationship with the employer is evaluated based on all the relevant facts and circumstances related to the educational aspect of the relationship. 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 school, college or university within the meaning of paragraph (c)(2) of this section at which the employee is enrolled and regularly attending classes.

(v) Evaluating service aspect. The service aspect of an employee's relationship with the employer is evaluated based on the facts and circumstances related to the employee's employment. Services of an employee with the status of a full-time employee within the meaning of paragraph (d)(3)(iii) of this section are not incident to and for the purpose of pursuing a course of study. Relevant factors in evaluating the service aspect of an employee's relationship with the employer are described in paragraphs (d)(3)(v)(A), (B), and (C) of this section.

(A) Normal work schedule and hours worked. If an employee is not a full-time employee within the meaning of paragraph (d)(3)(iii) of this section, then the employee's normal work schedule and number of hours worked per week are relevant factors in evaluating the service aspect of the employee's relationship with the employer. As an employee's normal work schedule or actual number of hours worked approaches 40 hours per week, it is more likely that the service aspect of the employee's relationship with the employer is predominant. The determination of the employee's normal work schedule and actual number of hours worked is not affected by the fact that some of the services performed by the individual may have an educational, instructional, or training aspect.

(B) Professional employee.

(1) If an employee has the status of a professional employee, then that suggests that the service aspect of the employee's relationship with the employer is predominant. A professional employee is an employee--

(i) 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;

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

(iii) 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.

(2) Licensed, professional employee. If an employee is a licensed, professional employee, then that further suggests the service aspect of the employee's relationship with the employer is predominant. An employee is a licensed, professional employee if the employee is required to be licensed under state or local law to work in the field in which the employee performs services and the employee is a professional employee within the meaning of paragraph (d)(3)(v)(B)(1) of this section.

(C) Employment Benefits. 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. For example, eligibility to receive vacation, paid holiday, and paid sick leave benefits; eligibility to participate in a retirement plan described in section 401(a); or eligibility to receive employment benefits such as reduced tuition, or benefits under section 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), or 137 (adoption assistance) suggest that the service aspect of an employee's relationship with the employer is predominant. Eligibility to receive health insurance employment benefits is not considered in determining whether the service aspect of an employee's relationship with the employer is predominant. The weight to be given the fact that an employee is eligible for a particular benefit may vary depending on the type of employment benefit. For example, eligibility to participate in a retirement plan is generally more significant than eligibility to receive a dependent care employment benefit. Additional weight is given to the fact that an employee is eligible to receive an employment benefit if the benefit is generally provided by the employer to employees in positions generally held by non-students.

(e) Effective date. Paragraphs (c) and (d) of this section apply to services performed on or after April 1 , 2005.

Mark E. Matthews ,

Deputy Commissioner for Services and Enforcement.

Approved: December 15, 2004

Gregory F. Jenner,

Acting Assistant Secretary of the Treasury.