

MEMORANDUM

To : Distribution List

From : R. Keith Gernold, UH Tax Director

Date : May 28, 2004

Subject : Student Exclusion from FICA Coverage

In 1999, the State of Texas modified its Section 218 Agreement with the Social Security Administration to exclude qualified student employees of universities from Social Security and Medicare withholding for services performed after June 30, 2000.

The so-called “student FICA exception” involves a provision of the Internal Revenue Code (Section 3121(b)(10)) which allows an exemption from U.S. Social Security and Medicare tax on wages for services performed in the employ of a school, college, or university by “a student who is enrolled and regularly attending classes” at the institution. The exemption is intended to apply to employment that is “incident to and for the purpose of pursuing a course of study.” In addition, effective February 25, 2004, the IRS issued proposed regulations, which set forth further guidance. However, changes to this guidance are anticipated by institutions of higher education.

Highlights of the statutes, regulations, and procedure are as follows:

1. All students who are half-time undergraduate or half-time graduate students will qualify for the exclusion, regardless of the number of hours worked, the amount of remuneration, the type of services performed, or the place where the services are performed. The term “half-time undergraduate student” has the same meaning as the term in the Department of Education regulations. “Half-time graduate or professional student” is defined as a student who is carrying at least a half-time academic workload at an institution of higher education as determined by that institution’s standards and practices.
2. Students who are classified as “career employees” are not eligible for the exclusion. The definition of a “career employee” is essentially an individual who is (i) eligible to participate in a section 401 or 403(b) retirement plan (**Note** – Only if the student-employee is also eligible to receive matching 403(b) contributions by the school), (ii) eligible for reduced tuition (other than section 117(d)(5) qualified tuition reduction provided to a teaching or research assistant who is a graduate student) because of the individual’s employment relationship with the institution, or (iii) classified by the institution as a career employee. An individual who is a career employee for one job position at an institution would be a career employee for any other position as well. In addition, services of a student attending classes at one university campus and working

part-time at another university campus, both of which are part of the same university, are subject to the student exclusion.

3. The determination of a student's half-time status is made about one week before each payroll period (i.e. biweekly / monthly) is finalized. Services of a qualifying student that are performed during all payroll periods of a month or less that fall wholly or partially within the academic term are eligible for the exemption. Services performed by a qualifying student during school breaks of more than five weeks, including summer breaks of more than five weeks, are not eligible for the exemption except for services performed during payroll periods that span into the break. Services of a student performed during breaks of five weeks or less are eligible for the exemption provided the student qualifies 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.
4. The exemption does not apply to postdoctoral students, postdoctoral fellows, medical residents (e.g. optometry and pharmacy residents), or medical interns, because the IRS believes that "it cannot be assumed" that the services performed by these persons are incidental to their academic studies.
5. The Student FICA Rule applies to U.S. citizen and foreign national individuals alike. However, foreign national individuals in the United States in F-1, J-1, M-1, or Q-1 immigration status can qualify for exemption from Social Security and Medicare taxes under Section 3121(b)(19) of the Code provided that they 1) are nonresident aliens for federal tax purposes under the substantial presence test (primarily, F-1 for 5 calendar years and J-1 for 2 calendar years) and 2) the services performed carry out the purpose of that immigration status. This exemption applies to all individuals meeting the criteria irrespective of whether or not they or the services that they provide qualify under the Student FICA Rule.