

Medical Resident FICA Tax Refunds: Status Update and the April 15 Deadline

April 9, 2009

A question currently troubling academic medical centers across the country is whether the stipends paid to their medical residents are exempt from Social Security Federal Insurance Contributions Act (FICA) taxes as amounts paid to students enrolled or regularly attending classes at a school, college, or university. Over a billion dollars in FICA taxes are now at stake for teaching hospitals and medical residents. While the IRS and the Department of Justice (DOJ) scored some early victories in several district court decisions, the Second and Sixth Circuits have recently joined the Seventh, Eighth, and Eleventh Circuits in holding that the student FICA tax exception under Internal Revenue Code (the Code) section 3121(b)(10) is not inapplicable to medical residents as a matter of law.

In the most recent of these decisions, issued March 25, in the U.S. Court of Appeals for the Second Circuit overturned two New York federal district court decisions that held that as a matter of law, medical residents are “categorically ineligible” for the student FICA tax exception. *U.S. v. Memorial Sloan-Kettering Cancer Center*, No. 07-0926-cv(L) (2d Cir. March 25, 2009); *Albany Medical Center v. U.S.*, No. 07-0949-cv(Con) (2d Cir. March 25, 2009). The Second Circuit’s decision follows on the heels of the Sixth Circuit’s decision in *U.S. v. Detroit Medical Center*, No. 07-1602, 2009 U.S. App. Lexis 3760 (6th Cir. Feb. 26, 2009). Like the Sixth Circuit, the Second Circuit remanded the cases to their respective district courts to conduct a factual inquiry as to whether the medical residents are “students” and the teaching hospitals “schools.”

These decisions serve as a timely reminder that teaching hospitals should explore several issues and related questions regarding their prior and prospective treatment of this issue, especially as it relates to the statute of limitations:

- The critical need to file protective refund claims for the 2005 FICA tax year before the statute of limitations expires at midnight on April 15, 2009.
- The need for protective refund claims for the 2005 FICA tax year to be filed differently than protective refund claims for earlier years.
- Will the IRS finally revisit and release the Appeals Settlement Guidelines that were drafted in 2005 to settle these refund claims without costly litigation? When will the IRS acquiesce to the circuit courts that have uniformly concluded that this is a question of fact?
- What should be done with protective refund claims that are being held in suspense by the IRS Service Centers?

- Will refund claims held in suspense become precluded by an alternative statute of limitations theory developed by the DOJ on dormant claims?

While all of these issues should be timely reviewed by each teaching hospital, the most pressing issue is the need to immediately file protective refund claims for the 2005 calendar year. The 2005 FICA tax year expires on April 15, 2009. All protective refund claims must be filed no later than midnight April 15, 2009. The failure to file a protective refund claim on or before April 15, 2009 will permanently foreclose the ability to seek a refund of any overpaid FICA taxes for 2005. The advantage of filing a protective refund claim is that it is a simple and inexpensive method to preserve your claim pending further resolution in the courts or future IRS guidance/acquiescence to these mounting decisions. However, be careful when filing such claims for the 2005 FICA tax year, since they should be filed differently than prior protective refund claims.

The remaining issues highlighted above should also be addressed, although the timing is not quite as crucial. Morgan Lewis is in the distinctive position of having attorneys with both government and private-sector experience with student FICA issues, including working on the Treasury Department's initial guidance on the student FICA exemption, representing one of the three teaching hospitals involved in the IRS draft Appeals Settlement Guidelines for this issue, and active involvement in three of the litigated cases. These varying perspectives allow us to provide unique guidance and insight into filing protective refund claims, working on alternatives to expensive litigation, and advising clients on how to proceed when a protective refund claim lies dormant too long.

If you have any questions about any of the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

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