

**UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA**

Regents of the University
of Minnesota,

Plaintiff,

Civ. No. 06-5084 (RHK/JSM)
**MEMORANDUM OPINION
AND ORDER**

v.

United States of America,

Defendant.

Thomas W. Tinkham, Kristina W. Carlson, John W. Windhorst, Jr., Christopher R. Duggan, Emily L. Fitzgerald, Theresa M. Bevilacqua, William R. Goetz, Dorsey & Whitney LLP, Minneapolis, Minnesota, William P. Donohue, University of Minnesota, Minneapolis, Minnesota, for Plaintiff.

Michael R. Pahl, Trial Attorney, Tax Division, United States Department of Justice, Washington, D.C., for Defendant.

INTRODUCTION

Plaintiff Regents of the University of Minnesota (the “University”) commenced this action against Defendant United States of America seeking a refund of the FICA taxes withheld and paid on medical residents’ stipends during the second quarter of 2005.¹ The amount of the University’s claim is \$1,094,803.92, plus interest. The University has moved for summary judgment. For the reasons stated below, the Court will grant that Motion.

¹ FICA taxes refer to taxes collected pursuant to the Federal Insurance Contributions Act (“FICA”).

BACKGROUND

The University operates graduate medical education programs for medical residents and fellows (“residents”). (Compl. ¶ 5.) A medical resident is an individual who has earned a medical degree and is participating in a residency program for additional medical training in a specialty field, such as internal medicine or surgery. The University entered into affiliation agreements with certain hospitals in Minnesota for the purpose of providing educational experiences to the residents.² (See, e.g., Pahl Decl. Tab 2 Ex. 114 at UM 02692.) Pursuant to the affiliation agreements, the University had responsibility for the general educational experience of the residents, including (1) determining educational goals, (2) establishing prerequisite criteria for placement, (3) determining completion of assignments, (4) evaluating the residents’ performance, and (5) selecting and appointing staff members at the affiliated hospital to the faculty of the University for the purpose of training the residents. (Id. at UM 02692-02693.) Staff physicians appointed to the University faculty had the “responsibility for teaching, supervising, and evaluating the performance of residents.” (Id. at UM 02695.) In addition, the University paid a stipend to the residents for the purpose of providing a minimum level of financial support during their enrollment. (Compl. ¶ 5.)

FICA imposes taxes upon employers and employees for the support of the social security system. See 26 U.S.C. § 3101 *et seq.* FICA taxes must be paid on “wages.” Id.

² The University sold its own hospital to Fairview in 1997. (See Doc. No. 28 at ¶¶ 6-10, Ex. 5.)

FICA defines “wages” as “all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash.” 26 U.S.C. § 3121(a). Employers collect FICA taxes by withholding the required amounts from their employees’ wages. See 26 U.S.C. § 3102(a). Employers also pay FICA contributions equal to the amounts withheld from their employees’ wages. See 26 U.S.C. § 3111(a). “Thus, FICA taxes are ‘paid in part by employees through withholding, and in part by employers through an excise tax.’” Ahmed v. United States, 147 F.3d 791, 794 (8th Cir. 1998) (quoting United States v. Lee, 455 U.S. 252, 254 n.1 (1982)).

FICA, however, excludes several categories of “service” from “employment,” including “service performed in the employ of . . . a school, college, or university . . . if such service is performed by a student who is enrolled and regularly attending classes at such school, college, or university.” 26 U.S.C. § 3121(b)(10) (“Student Exclusion”).

In 1998, the Eighth Circuit Court of Appeals held that stipends paid by the University to medical residents in 1985-1986 qualified for the Student Exclusion from FICA taxation. See Minnesota v. Apfel, 151 F.3d 742 (8th Cir. 1998). In 2003, this Court similarly held that stipends paid by the Mayo Foundation to its medical residents in 1994-1996 qualified for the Student Exclusion.³ See United States v. Mayo Found. for Med. Educ. & Research, 282 F. Supp. 2d 997 (D. Minn. 2003) (“Mayo I”), appeal

³ In 2006, this Court entered judgment dismissing a tax refund case related to stipends paid to residents at Mayo for the period of 1997-2003, pursuant to the parties’ stipulation that the residents’ stipends were similarly excluded from FICA tax coverage during those years. See Mayo Found. for Med. Educ. & Research v. United States (D. Minn. Civ. No. 05-467, judgment entered May 5, 2006).

dismissed by stipulation (8th Cir. File No. 03-3662, Jan. 7, 2004). In response to Apfel and Mayo I, the IRS amended its regulations in 2004 (effective April 1, 2005) so that medical residents no longer qualified for the exclusion.

The amended regulations provide in pertinent part that student status is determined by “the relationship of the employee with the organization employing the employee.” (“General Rule”)⁴ 26 C.F.R. § 31.3121(b)(10)-2(d). In particular, an employee is deemed a student if the services provided are “incident to and for the purpose of pursuing a course of study.” 26 C.F.R. § 31.3121(b)(10)-2(d)(3)(i). In addition, “[t]he 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.” Id. The “educational” and “service” aspects of the relationship are based “on all the relevant facts and circumstances.” Id.

However, the amended regulations also provide that “an employee whose normal work schedule is 40 hours or more per week is considered a full-time employee,” and therefore services performed by that individual are “not incident to and for the purpose of pursuing a course of study.” 26 C.F.R. § 31.3121(b)(10)-2(d)(3)(iii) (“Full-time Employee Exception”). In addition, an employee’s “normal work schedule” is “not

⁴ The amended regulations also added a “primary function test” to the definition of a “school, college, or university.” 26 C.F.R. § 31.3121(b)(10)-2(c). By comparison, the pre-amended regulations provided that “[t]he term ‘school, college, or university’ within the meaning of this exception is to be taken in its commonly or generally accepted sense.” 26 C.F.R. § 31.3121(b)(10)-2(d) (Pre-4/1/05). There is no dispute that the University meets either definition.

affected by the fact that the services performed by the employee may have an educational, instructional, or training aspect.” *Id.* Consequently, a medical resident who works 40 or more hours per week no longer qualifies for the Student Exclusion.

In contrast, the pre-amended regulations provided that student status should be determined “on the basis of the relationship of such employee with the organization for which the services are performed” and that “[a]n employee who perform[ed] services in the employ of a school, college, or university, as an incident to and for the purpose of pursuing a course of study” was a student. 26 C.F.R. § 31.3121(b)(10)-2(c) (Pre-4/1/05). The pre-amended regulations did not have a Full-time Employee Exception.

The University withheld and paid FICA taxes on the stipends it paid to medical residents enrolled in its residency programs during the second quarter of 2005. Thereafter, the University timely filed a refund claim with the IRS for \$1,094,803.92, asserting that the Full-time Employee exception of the amended regulations was invalid. The IRS did not act upon the claim, and in December 2006, the University filed this action.⁵ *See* 26 U.S.C. § 6532. In August 2007, this Court held that the amended regulations were invalid. *See Mayo Found. for Med. Educ. & Research v. United States*, 503 F. Supp. 2d 1164, 1171-77 (D. Minn. 2007) (“Mayo II”).⁶

⁵ Count One of the University’s Complaint seeks a refund of the FICA taxes withheld and paid on the residents’ stipends during the second quarter of 2005 on the basis that the Full-time Employee Exception is invalid. Counts Two, Three, and Four seek the same relief under alternative theories. (*See* Compl. ¶¶ 19-37.)

⁶ The Government has appealed Mayo II to the Eighth Circuit.

STANDARD OF DECISION

Summary judgment is proper if, drawing all reasonable inferences in favor of the nonmoving party, there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986). The moving party bears the burden of showing that the material facts in the case are undisputed. Celotex, 477 U.S. at 322; Mems v. City of St. Paul, Dep't of Fire & Safety Servs., 224 F.3d 735, 738 (8th Cir. 2000). The Court must view the evidence, and the inferences that may be reasonably drawn from it, in the light most favorable to the nonmoving party. Graves v. Ark. Dep't of Fin. & Admin., 229 F.3d 721, 723 (8th Cir. 2000); Calvit v. Minneapolis Pub. Schs., 122 F.3d 1112, 1116 (8th Cir. 1997). The nonmoving party may not rest on mere allegations or denials, but must show through the presentation of admissible evidence that specific facts exist creating a genuine issue for trial. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 256 (1986); Krenik v. County of Le Sueur, 47 F.3d 953, 957 (8th Cir. 1995).

ANALYSIS

The University asserts that the Full-time Employee Exception of the amended regulations is invalid because it is inconsistent with the plain meaning of the Student Exclusion or, alternatively, conflicts with regulations promulgated by the Social Security Administration. (Pl.'s Mem. at 10-15.) It also contends that the Government is barred by collateral estoppel from re-litigating whether medical residents qualify for the Student Exclusion or, alternatively, that residents qualify for the exclusion based on the merits.

(Pl.'s Reply Mem. at 15-29.) In response, the Government asserts that collateral estoppel does not apply because the controlling facts and applicable legal rules have changed.

(Def.'s Second Opp'n Mem. at 31-43.) It further argues that there is a genuine issue of material fact as to whether residents qualify for the Student Exclusion. (Id. at 5-29; 44-54.) Finally, the Government briefly argues that the amended regulations are valid, but recognizes that this Court held otherwise in Mayo II.⁷ (Id. at 54-56.)

Because the Court previously held in Mayo II that the Full-time Employee Exception of the amended regulations is invalid, it is not necessary to address the collateral-estoppel issue or whether the amended regulations conflict with the regulations from the Social Security Administration. Therefore, the Court will determine (1) whether the residents were "employed" by the University and (2) whether they were "students" who "regularly attend[ed] classes" at the University so as to qualify for the Student Exclusion.

⁷ The Government asserts that this Court's review of the amended regulations is governed by Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), and not National Muffler Dealers Ass'n, Inc. v. United States, 440 U.S. 472 (1979). In support of this argument, the Government relies upon Swallows Holding, Ltd. v. Commissioner, 515 F.3d 162, 167 (3rd Cir. 2008), which held "that the Tax Court erred in applying National Muffler to the extent that the National Muffler factors are inconsistent with [the] Chevron analysis." In Mayo II, this Court stated that "[t]here is no indication that the standard in National Muffler was changed by Chevron. Regardless, the Court reaches the same conclusion under either standard." 503 F. Supp. 2d at 1171. Indeed, the Government fails to get past the first prong of the Chevron analysis because this Court held in Mayo I that the statutory language of the Student Exclusion was clear and unambiguous. Id. at 1171-73, 1175-76 (citing Mayo I, 282 F. Supp. 2d at 1007, 1013-18). Under Chevron, if the statutory language is clear, the Court's inquiry ends and the plain meaning of the statute governs the action. 467 U.S. at 842-43.

