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memorandum**

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(Tax Exempt & Government Entities)

from: Neil D. Shepherd, Senior Counsel, Employment Tax Branch 2, Division  
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subject:

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

ISSUE

Whether amounts paid to post-doctoral fellows under certain non-NRSA grants are subject to Federal Insurance Contributions Act (FICA) taxes.

CONCLUSION

Amounts paid to post-doctoral fellows under the non-NRSA grants that were reviewed are subject to FICA.

## FACTS

Taxpayer has filed a refund claim for Old-Age, Survivors, and Disability Insurance and Hospital Insurance taxes (collectively referred hereinafter as FICA taxes) paid with respect to payments to certain post-doctoral fellows for the years Year 1-Year 5. Taxpayer asserts that amounts paid to post-doctoral fellows and funded through grants other than National Research Service Awards (NRSA grants) are not wages for FICA purposes.

Taxpayer is a state university with various departments and programs performing research. Taxpayer applies for grants from public and private sources to fund much of this research. Taxpayer's research is performed not only by faculty members but also by post-doctoral fellows and graduate students, undergraduate students, and other individuals hired to work on research projects.

The Taxpayer advertises post-doctoral fellowship positions for individuals who have received their doctorate degree from Taxpayer or another institution. Individuals with doctorate degrees can also become post-doctoral fellows by applying for an NRSA grant directly to HHS to support their appointment as a fellow with the Taxpayer.

The Taxpayer compensates post-doctoral fellows with stipends. The sources of these stipends vary—from the Taxpayer itself, to private grantmakers, to a variety of state and federal agencies. This analysis focuses on two broad categories of stipends, which will be further explained below: (1) NRSA grant payments, and (2) non-NRSA grant payments.

The Service and the Taxpayer have reached a sampling agreement under which the Service examined a selection of Year 5 payments.<sup>1</sup> Taxpayer claims that, for that year, a total of \_\_\_\_\_ of payments it made to post-doctoral fellows are not subject to FICA. Of this amount, the Taxpayer paid \_\_\_\_\_ under non-NRSA grants. The Taxpayer has agreed that the Service may adjust its FICA obligations for the years Year 1, Year 2, Year 3, and Year 4, based on any adjustments it proposes to the sample of the Year 5 payments.

### NRSA Grant Payments

The United States Department of Health and Human Services (HHS) awards NRSA grant payments to enable post-doctoral fellows to engage in research and research training. 42 U.S.C. § 288. Most NRSA awards are for three years, unless the applicant justifies more. 42 C.F.R. § 66.104.

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<sup>1</sup> During Year 5, the Taxpayer made a total of 164 payments to post-doctoral fellows. The Service examined each of the seven payments that the Taxpayer made to post-doctoral fellows under NRSA grants. However, the Service examined only 20 of the 157 payments that the Taxpayer made to post-doctoral fellows under non-NRSA grants.

**Application Process:** A post-doctoral fellow (or prospective fellow) applies to HHS for NRSA grant payments. If the application is successful, HHS then makes the grant payments to the institution that hosts the post-doctoral fellow. The institution, in turn, makes these payments to the applicant.<sup>2</sup>

**Content of Application:** HHS requires applicants to describe how their prospective host institution's facilities and programs will enable them to develop their research skills. Here it is common for applicants to describe a particular research division's or laboratory's background, atmosphere, and research approach. One applicant, for example, noted that one of the Taxpayer's particular programs had "many collaborators providing ample equipment and expertise in many departments," and that the Taxpayer "ha[d] a long history of commitment to interdisciplinary research."

These applications require potential sponsors to provide information, too. Here, for example, potential sponsors must specify "the number of fellows/trainees to be supervised during the fellowship." One potential sponsor illustrated this section's purpose when he acknowledged that a "concern to anyone reading this description is whether [the applicant] will receive adequate attention from me." This sponsor assured HHS that "[n]ow that much of [certain] immediate work has been accomplished, I intend to continue to delegate many of the responsibilities to my Associate Directors . . . and expect life to get easier."

Applications must also contain a description of the post-doctoral fellow's research training plan. In this section, one sponsor indicated that he designed the applicant's research plan to teach him "critical skills required for independent research," such as "critical reasoning," "impact questions," "technical skills," "written communications," and "experimental design."

**Calculation of Stipend:** HHS states that it calculates the amount of an NRSA award by "taking into account the cost of living, and such other factors as the needs of the program and the availability of funds." 42 C.F.R. § 66.107.

**Measurement of Progress:** HHS requires recipients of NRSA grants to prepare progress reports. These reports focus on the quantity and quality of research training that grant recipients have received. Recipients must detail "the research performed and research training" that they have obtained in the past year and expect to obtain in the

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<sup>2</sup> The NRSA awards both individual and institutional grants. This analysis focuses on individual grants. Institutional grants are those that HHS awards to institutions "to enable those institutions to make National Research Service Awards to individuals for research and training to undertake research . . ." 42 C.F.R. § 66.201. The primary functional difference between these awards is that HHS selects the recipients of individual grants, while institutions select the recipients of institutional grants. For the purposes of this analysis, the conditions that individuals must satisfy in order to secure and maintain both types of grants are the same.

next year. Additionally, in section 15 of these reports, sponsors analyze the progress of each post-doctoral fellow's research training.

**Changes in Research Plans:** HHS does not require awardees to secure its approval prior to changing the substantive focus of their research. Progress reports anticipate unilateral changes when they require each awardee to describe "any significant changes [that have] occurred in the training program." Changes can be significant. One awardee, for example, maintained funding despite changing host institutions. One sponsor told such an awardee that he was "pleased that [the individual was] enjoying the opportunities to broaden [her] skills . . . there is nothing quite like the freedom that is offered during the post-doctoral years." This sponsor went on to promise, "As far as I am able, I give trainees the chance to follow their ideas."

**Role in Recipient's Research Training:** HHS expects awardees primarily to use NRSA grant payments to develop their research skills. Applications and progress reports typically focus on the extent to which an awardee has used an NRSA grant to receive research training rather than the awardee's progress toward accomplishing specifically enumerated research goals. In one application, for example, an awardee acknowledged that he was "proposing a few techniques that [he had] never performed," but anticipated that the process of learning such techniques would be "an essential step in becoming an independent and critical thinking scientist." To a similar end, a sponsor's comments in an awardee's progress report focused on his belief that the fellowship provided the recipient research training that was "ideally suited to prepare her for a career in botanical medicine and women's health, which are her primary research interests."

**Responsibilities of Awardees:** HHS requires awardees to pursue research training on a full-time basis, defined as 40 hours per week or as specified by the sponsoring institution.

**Termination of Fellowship:** HHS may terminate an NRSA fellowship before its scheduled expiration date if it "finds that the awardee has materially failed to comply with the terms and conditions of the Award or to carry out the purpose for which it was made." 42 C.F.R. § 66.109.

**Fringe Benefits:** Awardees receive fringe benefits. They are entitled to normal vacations and holidays available to individuals in comparable training positions at the sponsoring institution, including fifteen days of paid sick leave per year and up to thirty days of parental leave per year. They are also entitled to health and dental insurance. HHS will not, however, allow the Taxpayer to use NRSA funds to provide a post-doctoral fellow with more insurance coverage than it provides other individuals with a similar training position. In addition, the NRSA limits the amount of its funds that the Taxpayer can spend on a post-doctoral fellow's health insurance.

The Taxpayer provides awardees' fringe benefits under a benefit system that is different from that of regular employees. It is in this vein that one post-doctoral fellow's appointment letter stated, "Trainees supported under the NRSA are not considered to be in an employee-employer relationship with the NIH or with the [Taxpayer]. Therefore your benefit eligibility status would change [if you secure an NRSA grant]."

These post-doctoral fellows are not entitled to retirement benefits. If a post-doctoral fellow has a retirement account when she receives the NRSA fellowship, HHS requires the Taxpayer to freeze contributions to the retirement account.

**Intellectual Property:** HHS retains certain rights to the intellectual property that awardees produce. When awardees publish their research, HHS requires them to acknowledge its support and to allow the government a royalty-free, nonexclusive, and irrevocable license to reproduce, translate, publish, use, and dispose of publications. Awardees are, however, free to copyright their publications. At the same time, no fellowship grant may contain any provision giving the Government any patent rights to inventions made by the fellow.

#### Non-NRSA Grant Payments

The Taxpayer compensates post-doctoral fellows with the proceeds of other research grants, too. In the sample reviewed, "non-NRSA grant payments" included awards to the Taxpayer funded by various government and private agencies. Each grant funded a specific research project. The Taxpayer used these grant awards in part to pay post-doctoral fellows. The purpose of non-NRSA grant payments to post-doctoral fellows is to fund particular research services.

Non-NRSA grants in the sample reviewed came from a variety of sources. National Institute of Health (NIH) Research Project Grants (R01) are an example of a non-NRSA grant. The NIH describes such a grant as, "an award to support a discrete, specified, circumscribed project to be performed by named Project Directors/Principal Investigators . . . ." These awards typically last for three to five years. The National Science Foundation (NSF) awards another example of a non-NRSA research grant. The NSF states that this award's purpose is "to fund specific research proposals that have been judged the most promising by a rigorous and objective merit-review system." The average duration of an NSF grant is three years. Other entities that have awarded the Taxpayer similar non-NRSA research grants include the Department of Energy (DOE), American Heart Association (AHA), Department of Agriculture (DOA), Mid-America Research and Development Foundation, and Proctor and Gamble.

One principal investigator succinctly summarized the nature of these awardees' relationship with the Taxpayer when he stated in an appointment letter, "I see your work in my lab as a collaboration in which I provide you with resources and you provide me with labor and we both exchange ideas and information." The Taxpayer, through the faculty sponsor, assigns the fellows tasks that are discrete, substantive, and specific.

The Taxpayer routinely refers to the tasks as “research objectives,” and assigns individuals with particular substantive goals. These research objectives include, for example, “experiments focused on the ethanol effects on nucleus,” “conducting DNA microarray experiments, while collecting tissue that will be used for proteomics,” investigating “the kinetics of MNV infections and shedding and the resistance/susceptibility to infection,” “modeling bird abundance,” “performing research on contaminant transformation in aquatic systems and development of environmental remediation technologies,” and improving “genetic and metabolic engineering efficiencies.”

**Application Process:** To secure the non-NRSA grants that it received, the Taxpayer had to submit an application that described a particular research project. A principal investigator or project director, who was to lead the project in most cases, signed the application and attested to its accuracy. Once the Taxpayer secured the grants, the government or private agency which made the grant (i.e., the “grantor”) provided the grant funds to the Taxpayer, which in turn used portions of these proceeds to compensate individuals who performed the research services necessary to satisfy the terms of the grant. Among these individuals are post-doctoral fellows.

At the time an institution applies for a non-NRSA grant, it typically has not hired or identified the post-doctoral fellows who will provide research services under the grant. It is therefore uncommon for applications to name and describe the particular post-doctoral fellows who will provide research services; grant applications instead typically summarize, in general terms, the nature and extent of the research services that the Taxpayer expects post-doctoral fellows to provide.

**Content of Taxpayer’s Application for Funding:** The Taxpayer’s applications for non-NRSA grants focus on the substance of the research services that it proposed to provide. The NSF, for example, requires applicants to provide a “project description,” which “should provide a clear statement of the work to be undertaken and must include: objectives for the period of the proposed work and expected significance; relation to longer-term goals of the [Principal Investigator’s] project; and relation to the present state of knowledge in the field, to work in progress by the [Principal Investigator] under other support and to work in progress elsewhere.”

The NSF then evaluates these projects based on the “intellectual merit of the proposed activity,” and the project’s “broader impacts,” including how the project will “enhance the infrastructure for research and education, such as facilities, instrumentation, networks, and partnerships.” The DOE states that, above all else, it evaluates such a prospective project’s “scientific and/or technical merit,” or its “educational benefits.” 10 C.F.R. § 605.10. And, in a similar way, the NIH evaluates potential R01 projects based on their significance, innovation, investigators, research environment, and the quality of the proposed approach.

**Selection of Fellow by Taxpayer:** The Taxpayer evaluates applicants who seek appointments as post-doctoral fellows under these grants based on their abilities to provide the particular research services that the grants require. In one application for a non-NSF grant, for example, the Taxpayer described the individual who it would hire as a post-doctoral fellow to provide research services under the grant as one “with experience in protein biochemistry or mass spectrometry,” or “very skillful in cloning work, gene expression analysis, and experience with tissue culture and transformation.” An appointment letter similarly informed a post-doctoral fellow that his “background and experience [were] an excellent match for [the] postdoctoral position.” Another appointment letter informed a post-doctoral fellow that his supervisor expected him “to utilize [his] past experience and skills . . . to answer the [project’s particular] research questions adequately.”

**Calculation of Stipend:** The Taxpayer typically sets the amounts of these non-NRSA post-doctoral fellows’ stipends at an amount commensurate with the market-rate value of their research services. One document, a “Statement of Actual Wage Determination,” demonstrates this. There, Taxpayer indicated to the AHA that it set a post-doctoral fellow’s salary at a level commensurate with his “Degree(s) earned,” “Area of specialization,” “Previous work experience,” and “Comparable rate of pay at similar institutions.” Another memorandum, a “justification for salary increase,” re-enforces this notion when a sponsor stated that the Taxpayer should raise a post-doctoral fellow’s annual salary “to retain personnel of [her] caliber.” To the same end, the Taxpayer stated in one application for a non-NRSA award that post-doctoral fellows’ “[s]alaries/wages are based upon University/Company established rates/salaries which are comparable to others doing similar research efforts both within and outside the University/Private Industry.”

**Measurement of Progress:** With respect to the Taxpayer’s progress towards accomplishing its research goals, granting agencies required it to provide progress reports. These reports focus on the quantity and quality of research services that the Taxpayer provided and was continuing to provide. DOE regulations, for example, require grant recipients to “[i]nclude results of work to date,” and to “[e]mphasize findings and their significance to the field.” 10 C.F.R. § 605.19.

The Taxpayer similarly measures an individual post-doctoral fellow’s progress under a non-NRSA grant based on the quantity and quality of the research services he has provided. In one post-doctoral fellow’s annual evaluation, for example, a principal investigator stated that an individual’s work was “exemplary” because he had made a number of substantive contributions to the research project. Another principal investigator stated that the “number of [peer]-reviewed publications [would be] the main factor that was used to assess [a post-doctoral fellow’s] productivity.” One performance letter illustrated this same concept, albeit from a different angle, when a principal investigator issued an unfavorable performance evaluation partially on the basis of the post-doctoral fellow’s “inability to focus sufficiently on projects to see them to completion.”

**Changes in Research Plans:** Grantors of the Taxpayer's non-NRSA research grants required the Taxpayer to secure their approval prior to changing the substantive focus of the grant-sponsored research. The NSF's "general grant conditions," for example, explicitly state that "written prior approval from the NSF Grants officer is required for 'significant project changes,' including 'changes in objective or scope.'"

It is apparent that the Taxpayer subjects the individual post-doctoral fellows themselves to similar constraints, as appointment letters typically enumerate the tasks that the post-doctoral fellows will engage in, as described above. In appointment letters, the Taxpayer also routinely states that it will not use the proceeds of a non-NRSA research grant to compensate a post-doctoral fellow for engaging in research activities that are not substantively related to its non-NRSA research grant. It is common for these letters to state that those post-doctoral fellows who "wish to participate in other professional activities" are "welcome to do so on a *voluntary* basis." (emphasis added)

**Responsibilities of Awardees:** The Taxpayer typically hires the post-doctoral fellows whom it will compensate with non-NRSA grants with the expectation that they will apply existing research skills. The Taxpayer usually hires post-doctoral fellows to conduct the majority of the research services that the grantors' contracts with the Taxpayer require. In one application for DOE funding the principal investigator indicated that a postdoctoral research associate and Ph.D. graduate student would "complete a majority of the proposed lab tests, and associated data analysis and modeling." Similarly, another principal investigator indicated in a budget justification to the AHA that the post-doctoral fellow would "perform the bulk of the work" under the grant.

Progress reports indicate that it is common for post-doctoral fellows to devote all of their time to services under a particular non-NRSA research grant, rather than dividing their time among multiple projects.

**Termination of Fellowship:** The non-NRSA grants that were reviewed provided that the grantor would terminate payments under the grant before the grant's scheduled expiration date if the Taxpayer failed to meet its contractual commitments. The NSF, for example, states that grants may be suspended or terminated "when the grantee has materially failed to comply with the terms and conditions of the award." The NIH requires recipients of R01 awards to comply with the terms contained in the "Notice of Award," which, among other conditions, states that "funding for subsequent budget periods are generally provided in annual increments following annual assessments of progress."

The Taxpayer, meanwhile, will terminate an individual post-doctoral fellow's payments under a non-NRSA grant if the individual fails to provide the research services that the grant requires. Thus, appointment letters typically indicate that individuals will maintain their fellowships if their performance is "adequate" or their progress is "satisfactory."



One appointment renewal letter stated that the Taxpayer was renewing an individual's fellowship based on his receiving "a satisfactory annual performance evaluation."

**Fringe Benefits:** The Taxpayer provides fringe benefits to post-doctoral fellows who receive stipends under non-NRSA grants. Responses to IDRs indicate that the Taxpayer provided all individuals who received non-NRSA fellowships with health and life insurance. In particular, certain appointment letters stated that (1) non-NRSA post-doctoral fellows were eligible for all "benefits available to academic employees," (2) post-doctoral fellows were eligible to purchase health and dental insurance for their families under the Taxpayer's plan, and (3) these post-doctoral fellows were eligible for retirement benefits.

**Intellectual Property:** Grantors of Taxpayer's non-NRSA research grants, and the Taxpayer, typically retained certain rights to any intellectual property generated under the research grants. The terms of the grants typically required post-doctoral fellows (as well as all others operating under the grant) to "include a formal acknowledgement of [grantor] support" in "[a]ll publications, posters, oral presentations at scientific meetings, seminars, and any other forum in which results of the [research were] presented." Meanwhile, in one appointment letter, a principal investigator stated, "I consider that any data you generate are property of the laboratory and that copies of your notebooks and computer files will stay in the lab after you leave."

**Work Specifications:** Post-doctoral fellows generally work under a small set of supervisors, typically one or two principal investigators. Among the documents that the Taxpayer has provided are appointment letters, for example, that describe post-doctoral fellows' duties in terms such as to "work with [the same principal investigator] during [the] appointment," or "to plan, conduct, and publish research with [his supervisor]." Other documents reflect the Taxpayer's authority over how fellows spend their time. One appointment letter, for example, indicated that the post-doctoral fellow's principal investigator would "supervise all aspects of the project." Documents also indicate that the Taxpayer had influence over post-doctoral fellows' choices of assistants. For example, the Taxpayer's application for a DOA research grant indicated that it would hire one of its undergraduate students to assist its post-doctoral fellow. Meanwhile, almost without exception, the Taxpayer specified the substantive work that each non-NRSA post-doctoral fellow was to perform. In one appointment letter, for example, the Taxpayer expressly assigned a post-doctoral fellow to conduct research, participate in on-going seminars in the department, and attend a specific teaching workshop. Similarly, the appointment letters under non-NRSA grants routinely stated that the Taxpayer would not compensate post-doctoral fellows for participating in activities unrelated to the Taxpayer's contract with the grantor. Finally, the Taxpayer routinely specified the order or sequence along which non-NRSA post-doctoral fellows' research was to proceed. For example, a principal investigator stated in one appointment letter that upon completion of two years of post-doctoral training, the post-doctoral fellow was to have prepared four peer-reviewed publications, and submitted a grant proposal as either principal investigator or co-principal investigator. Another principal investigator

stated that, “Research training is expected to culminate in at least one manuscript suitable for publication in a referenced journal.” In an application for DOA funding, another principal investigator stated that he would hire a post-doctoral fellow who would spend the first year under the grant “completing the suppressor screen with the assistance from an undergraduate student.”

## LAW

Fellowship grants are subject to FICA tax if they are wages under § 3121(a). Wages are generally amounts paid in consideration for employment. Whether there is an employment relationship between an institution that disburses funds from a grant and a researcher who receives payment in connection with performing research depends on all the facts and circumstances.

### Income Tax Treatment

Under § 117(a) of the Code, gross income does not include any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization described in § 170(b)(1)(A)(ii) (describing, generally, a school).

Under § 117(b), only “qualified scholarships” may be excluded from income. A qualified scholarship means any amount received by an individual as a scholarship or fellowship grant to the extent that the amount was used for “qualified tuition and related expenses.” Amounts received for room, board, travel, and incidental living expenses are not related expenses. Section 117(c) of the Code provides that the exclusion for qualified scholarships shall not apply to that portion of any amount received which represents payment for teaching, research, or other services by the student required as a condition for receiving the qualified scholarship or fellowship. A scholarship or fellowship grant conditioned upon either past, present, or future services by the recipient, or upon services that are subject to the direction or supervision of the grantor, represents payment for services. Additionally, a requirement that the recipient pursue studies, research, or other activities primarily for the benefit of the grantor is treated as a requirement to perform services. See, e.g., United States v. Memorial Sloan-Kettering Cancer Center, 563 F.3d 19, 31 (2d Cir. 2009); United States v. Partners Healthcare System, Inc., 591 F. Supp. 2d 116, 122 (D. Mass. 2008); Spiegelman v. Commissioner, 102 T.C. 394, 398 (T.C. 1994).<sup>3</sup>

### Employment Tax Treatment

Sections 3101 and 3111 impose FICA taxes on “wages,” as that term is defined in

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<sup>3</sup> These cases explicitly cite Treas. Reg. 1.117-4(c). Although Treas. Reg. 1.117-4(c) generally applies only in the case of scholarships or fellowships granted before 1986, courts continue to apply its criteria (i.e., considering whether (1) the payment is conditioned upon past, present or future services by the recipient, and (2) the payment’s primary purpose is to benefit the grantor) when deciding cases under § 117(c).

§ 3121(a). In general, fellowship stipends that are excludable from gross income under § 117 are not subject to FICA. § 3121(a)(20).

Any stipend, however, that represents compensation for research, teaching, or other services under the standards of § 117(c) is subject to FICA if it is “remuneration for employment.” Consistent with the statute, the Service has taken the position that amounts that represent payment for services under § 117(c) are wages for the purposes of income tax withholding under § 3401(a). Notice 87-31, 1987-1 C.B. 475. The application of FICA or FUTA, however, depends on the nature of the employment and the status of the organization. Id.

### Section 117(c)

Section 117’s exclusion from gross income does not apply “to that portion of any amount received which represents payment for teaching, research, or other services . . . .” § 117(c). Courts and the Service have taken the position that an amount is not excludable under § 117(c) if the amount either (1) enables the recipient to pursue studies or research primarily for the benefit of the grantor,<sup>4</sup> or (2) represents compensation for past, present, or future services.<sup>5</sup>

Determining whether payments to a post-doctoral fellow under a particular research grant constitute payment for services for the purposes of § 117(c) is an inherently factual matter, requiring consideration of the nature and extent of the duties imposed upon the participants, and of all other relevant facts and circumstances of the programs.

Courts have held that a variety of facts and circumstances indicate that a payment’s purpose is to enable the recipient to pursue studies or research primarily for the benefit of the grantor, such as:

- The grantor awarded the research grant to the institution, rather than to the student. See, e.g., Cassady v. Commissioner, 52 T.C.M. (CCH) 1130 (T.C. 1986).
- The recipient would not continue to receive payments if he did not continue to perform the required services. See, e.g., Farmer v. Commissioner, 59 T.C.M. (CCH) 439 (T.C. 1990).
- The university required and limited recipients to working on subjects within the areas of research already being carried on at the institution. See, e.g., Cassady v. Commissioner, 52 T.C.M. (CCH) 1130 (T.C. 1986).

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<sup>4</sup> See, e.g., United States v. Detroit Medical Center, No. 05-71722, 2006 WL 3497312 (D. Mich. Dec. 1, 2006), aff’d, No. 07-1602 (6th Cir. Feb. 26, 2009)

<sup>5</sup> See, e.g., Farmer v. Commissioner, 59 T.C.M. (CCH) 439 (T.C. 1990)

- Recipients bear a large degree of responsibility for the success of the institution's research projects. See, e.g., Christman v. Commissioner, 57 T.C.M. (CCH) 538 (T.C. 1989).
- Payment recipient's research training is the payment's incidental benefit, rather than its primary purpose. See, e.g., United States v. Detroit Medical Center, No. 05-71722, 2006 WL 3497312 (D. Mich. Dec. 1, 2006), aff'd, No. 07-1602 (6th Cir. Feb. 26, 2009). See also Farmer v. Commissioner, 59 T.C.M. (CCH) 439 (T.C. 1990) ("The fact that [recipient's] teaching also aided his academic progress does not turn the compensation he received into scholarship income.").

Courts and the Service have also determined that a variety of facts and circumstances indicate that an amount represents compensation for past, present, or future services. For example:

- Institution requires recipients to perform discrete tasks. See, e.g., Sager v. Commissioner, 55 T.C.M. (CCH) 825 (T.C. 1988).
- Payments are commensurate with a recipient's ability to provide services, rather than with the recipient's financial need. See, e.g., Piazza v. Commissioner, 56 T.C.M. (CCH) 1027 (T.C. 1989).
- Institution reserves preferential rights to the results of, and intellectual property generated by, the recipient's research. See, e.g., Rev. Rul. 73-564, 1973 C.B. 28.
- Grantee receives fringe benefits normally associated with an employer-employee relationship. See, e.g., Sebberson v. Commissioner, 781 F.2d 1034 (4th Cir. 1986). See also Christman v. Commissioner, 57 T.C.M. (CCH) 538 (T.C. 1989) (noting that the institution gave the grantee group hospitalization insurance, term life insurance, disability insurance, and malpractice insurance); Piazza v. Commissioner, 56 T.C.M. (CCH) 1027 (T.C. 1989) (holding that a payment was taxable partially because "each intern was entitled to two weeks leave annually").

Examples of facts and circumstances that courts have determined indicate that a payment's primary purpose is to enable the recipient to pursue studies or research that are not primarily for the benefit of the grantor include:

- Payment's attendant circumstances focus on the experience to be gained by the recipient, rather than benefit to the grantor. See, e.g., Bingler v. Johnson, 394 U.S. 741 (1969).
- The program encourages the institution to provide the recipient with a wide variety of substantive experiences. See, e.g., Smith v. Commissioner, 51 T.C.M.

(CCH) 1348 (T.C. 1986).

- The institution does not substantially limit the substance of the recipient's research plan. See, e.g., Turek v. United States, No. 84 C 9228, 1986 WL 11615 (N.D. Ill. Oct. 10, 1986).

Finally, Courts have held that a variety of facts and circumstances indicate that the amount provided by the grantor does not represent compensation for past, present, or future services, including:

- Institution does not require the recipient to provide particular past, present, or future services. See, e.g., Smith v. Commissioner, 51 T.C.M. (CCH) 1348 (T.C. 1986) (observing that the recipient "worked solely on her studies or her theory during the time in question. The university did not receive a direct substantial benefit from the petitioner's research."). See also Vaccaro v. Commissioner, 58 T.C. 721 (T.C. 1973).
- Recipient helps define his own research issues. See, e.g., Turek v. United States, No. 84 C 9228, 1986 WL 11615 (N.D. Ill. Oct. 10, 1986).

In view of the purpose of the NRSA program and the circumstances of its implementation, the Service's administrative position has been that payments under NRSA research grants are not payments for services under § 117(c). See generally Rev. Rul. 83-93, 1983-1 C.B. 364 (obsoleting Rev. Rul. 77-319, 1977-2 C.B. 48).

### Remuneration for Employment

Section 3121(d)(2) of the Code provides that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Treas. Reg. § 31.3121(d)-1 indicates that this determination requires a consideration of all of a particular case's facts and circumstances. Particularly relevant here are those facts and circumstances that provide evidence of the degree of control that a business exercises over its employees. The Service's position is that facts that provide such evidence fall into three categories:

**Behavioral Control:** The more behavioral control that a business exercises over a worker, the more likely it is that the worker is an employee. Examples of factors that indicate such behavioral control include the business' authority over the worker's decisions regarding: (1) when and where to do the work, (2) what tools or equipment to use, (3) what workers to hire or to assist with the work, (4) where to purchase supplies and services, (5) what work must be performed by a specified individual, and (6) what order or sequence to follow.

**Financial Control:** Analogously, the more financial control that a business exercises over a worker, the more likely it is that the worker is an employee. Factors that indicate that the business exercises such financial control over a worker include: (1) the worker does not have a significant investment in assets or tools; (2) the worker gets paid whether or not he completes the job, and (3) the worker cannot make business decisions that affect his bottom line.

**Type of Relationship:** Finally, the more indicia of a traditional employer-employee relationship that the business-worker relationship bears, the more likely it is that the worker is an employee. Examples of such indicia include: (1) the presence of an employment contract, (2) fringe benefits, and (3) the permanency of the relationship.

Section 31.3121(d)-1(a)(3) of the regulations provides that if the relationship of an employer and employee exists, any designation or description of the parties as anything other than that of employer and employee is immaterial.

### ANALYSIS

Payments under the NRSA grants are not subject to FICA because they are not payments for services. However, payments the Taxpayer made under the non-NRSA grants that were reviewed are subject to FICA because, under the facts and circumstances, they are payments for services under § 117(c) and there is an employment relationship between the Taxpayer and the post-doctoral fellows receiving the payments.<sup>6</sup>

#### The NRSA Payments Are Not Payments for Services Under § 117(c)

Amounts post-doctoral fellows receive under NRSA grants are not subject to FICA because, on balance, they are not payments for services. Using the analytic framework for determining whether fellowships are payments for services that has developed under § 117(c), the relevant factors lead to the conclusion, on balance, that the grants fund the training and development of the post-doctoral fellows rather than performance of specific research or achievement of specific research goals.

#### NRSA grants' primary purpose is to benefit the recipient

The primary purpose of NRSA grants is to further the research training of the recipients in their individual capacities. HHS explicitly requires recipients of these grants to pursue research training full-time.

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<sup>6</sup> Amounts that Taxpayer's post-doctoral fellows receive under both NRSA and non-NRSA grant payments are not excludable from their gross incomes under § 117 because they are amounts paid to non-degree candidates for general living expenses. Therefore, § 3121(a)(20) does not exempt these amounts from FICA.

HHS awarded the NRSA grants under examination to individual fellows, rather than to Taxpayer or its faculty members.<sup>7</sup> The application and award process requires each grant to be tailored to an individual's training and development, rather than to Taxpayer's program or to HHS' research goals. At no point must applicants show that their presence at the faculty sponsor's Institution will benefit the Taxpayer nor do they have to establish that the specific proposed research will benefit HHS. HHS requires applicants to specify how their training plan, the Taxpayer's faculty, and the Taxpayer's facilities will be conducive to their research training. Applications specifically require potential sponsors to summarize their training plans and specify the number of other subordinates they will have who will distract their attention from helping applicants develop their research skills. Progress reports focus on the development of research skills rather than on research accomplishments. At no point in an NRSA fellowship's application process or during the term of the grant does HHS evaluate, or require the Institution to consider, the level of contribution that a recipient will make to the Institution's research projects. The flexibility that post-doctoral fellows have under NRSA grants similarly indicates that the purpose of the grants is training rather than accomplishment of specific research objectives. NRSA fellows may unilaterally change the substance of their research activities to maximize their individual development as researchers. They do not have to tailor their research to meet Taxpayer's research goals.

NRSA payments are not compensation for past, present, or future services

NRSA grants are not conditioned on post-doctoral fellows' provision of any particular quantity or quality of research services for the Taxpayer or anyone else.

When HHS evaluates applications for NRSA research grants, it primarily evaluates the applicant's potential to receive research training under a particular supervisor, at a particular institution, while pursuing a particular research training plan. Similarly, when a faculty sponsor prepares comments to be included in an NRSA fellow's progress reports, the sponsor evaluates the NRSA grant recipient's performance in terms of the research training, rather than substantive achievements. Progress reports and sponsor comments consistently and primarily focus on the quality and quantity of research training opportunities that recipients have pursued. Recipients can continue to receive NRSA grant payments despite not meeting the substantive goals that their supervisors set.

As the Taxpayer explicitly acknowledges, its relationship with post-doctoral fellows receiving NRSA funding is distinguishable from its relationship with its employees. While Taxpayer provides its employees with retirement benefits, HHS prohibits the Taxpayer from providing NRSA grant recipients with retirement benefits. And, although NRSA grant recipients were supervised by Taxpayer's employees, Taxpayer did not dictate in detail the order, sequence, substantive goals, and means of NRSA post-

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<sup>7</sup> As indicated in Footnote 2, HHS awards NRSA grants to both individuals and institutions.

doctoral fellows' research in the way that it dictated those of non-NRSA post-doctoral fellows. NRSA post-doctoral fellows' appointment letters, in fact, frequently encourage them to act independently and explore various topics. Non-NRSA post-doctoral fellows' funding is ultimately contingent on the extent to which they conform to the Taxpayer's directions, while NRSA fellows will be compensated so long as they can establish that they receive research training.

#### The non-NRSA Payments Are Payments for Services

Although the non-NRSA grants that were reviewed and NRSA grants share some similarities, for purposes of analyzing whether they constitute compensation for services, they are fundamentally different. Although the research performed was similar, the educational credentials of the recipients were similar, and the supervisors of both types of fellows could incorporate training into the supervision, payments to non-NRSA fellows are fundamentally different in that they are payments for the performance of specific services determined by the Taxpayer through the faculty sponsor rather than payments to support training and development. The difference in purpose is reflected in many aspects of the grants. They differ with respect to how fellows are selected to work under a grant, how work assignments are determined, whether a fellow can decide what work to do, how fellows are evaluated on their work, how stipend amounts are determined, and when fellows can be terminated. Many NRSA fellows also prepare and submit their own grant applications to HHS.

The Taxpayer conditions amounts that post-doctoral fellows receive under its non-NRSA grants on these individuals' provisions of particular substantive research services. The Taxpayer, through its employees, applies for the grant and defines the nature and scope of the research to be performed. In the majority of instances, the Taxpayer does not hire post-doctoral fellows until after it has secured the non-NRSA grant funding for the research. Unlike NRSA fellows who define their own research projects, the Taxpayer assigns non-NRSA fellows to research projects that are defined by the project leader. The Taxpayer assigns these post-doctoral fellows discrete research tasks under these projects. A supervisor typically defines a post-doctoral fellow's research goals and publication timeline. In fact, the terms of these grants prohibit the Taxpayer from varying the substance of the project without prior written approval from the granting agency. Appointment letters routinely indicate that the Taxpayer does not compensate these individuals for engaging in unrelated professional activities.

The Taxpayer bases its decisions to hire post-doctoral fellows on their potential to provide substantive services. Appointment letters thus routinely note the compatibility of post-doctoral fellows' past experiences and credentials with the substantive tasks that the Taxpayer would assign them.

Similarly, the Taxpayer evaluates the individuals' performance by referencing the quality of their substantive contributions. Appointment letters indicate that the Taxpayer does



not renew an individual's fellowship if it determines that his performance is not satisfactory. The terms of the non-NRSA grants indicate that the grantor can terminate the Taxpayer's grant if the Taxpayer does not make adequate progress in reaching its research objectives. Therefore, the Taxpayer has a reason to hold the fellows accountable for accomplishing specific research goals.

The post-doctoral fellows also receive more extensive fringe benefits than those received by the NRSA post-doctoral fellows. For example, these individuals may receive retirement benefits.

Each non-NRSA fellow is assigned a supervisor, or a small set of supervisors. This principal investigator typically enumerates the tasks, goals, means, and time frame of the post-doctoral fellow's research. For example, one appointment letter stated, "The specific nature of your duties will be determined by [your supervisor]." The letter then enumerates the means that the Taxpayer expects the post-doctoral fellow to employ. As noted above, NRSA fellows have greater latitude to design both their research objectives and their path for pursuing the research. For example, one NRSA post-doctoral fellow's appointment letter indicated that the Taxpayer was appointing her to pursue a research project that she had independently developed.

Although non-NRSA fellows inevitably receive training as a result of performing research tasks that are new to them and working with an experienced supervisor, the clear quid pro quo for the payments is the research work. The Taxpayer has a binding commitment under the grant to perform certain research, and the fellows are hired to help it meet that specific commitment. The contrast is highlighted by the fact that NRSA fellows can change their research project at their own initiative while non-NRSA fellows cannot. Also, non-NRSA fellows may not have their fellowships renewed if they are not achieving their assigned research goals while NRSA fellows are not held accountable for succeeding in their research. NRSA grants appear to be unusual, if not unique, in that they fund the training experience, irrespective of accomplishments. The non-NRSA grants have concrete research goals. Diligent, hard-working, highly-educated fellows no doubt learn from their fellowship experience regardless of how it is funded, but for purposes of determining whether the payments they receive are payments for services under section 117(c), the terms and conditions and expectations and obligations under the two grant categories result in a different outcome for non-NRSA grants. They are compensation for services.

#### The Taxpayer Has an Employment Relationship With the Non-NRSA Post-Doctoral Fellows

Balancing the facts and circumstances, the Taxpayer has an employment relationship with post-doctoral fellows who receive payments under the non-NRSA grants that were reviewed. The Taxpayer has behavioral and financial control, and the overall relationship of Taxpayer to the non-NRSA fellows is that of employer and employee.

Several factors indicate that the Taxpayer exercised behavioral control over these post-doctoral fellows. Appointment letters and progress reports routinely indicated that post-doctoral fellows conducted research under the guidance of a small set of supervisors. Appointment letters and progress reports also indicated that these supervisors had authority over when, where, and how the post-doctoral fellows were to conduct their research. These documents, for example, often explicitly specified that supervisors would oversee all aspects of the post-doctoral fellows' research efforts. Certain documents indicated that the Taxpayer limited the choice of assistants for some non-NRSA fellows to the undergraduate students who attended the Taxpayer's Institution. Appointment letters and other documents also indicate that the Taxpayer enumerated the post-doctoral fellow's specific research tasks. For example, one appointment letter stated the post-doctoral fellow would "be part of a team that will seek to integrate functional genomics information . . . with a cell biology effort . . . ." To the same end, in a letter requesting approval of another post-doctoral fellow's appointment, one supervisor stated that the appointee's "duty under this appointment shall mainly include performing research on contaminant transformation in aquatic systems and development of environmental remediation technologies." By contrast, NRSA fellows are allowed to adjust their research tasks. Finally, the Taxpayer routinely specified the order or sequence in which the post-doctoral fellows were to conduct their research and related activities and the time frames during which individuals would engage in particular tasks. For example, as indicated earlier, one appointment letter explicitly stated that the post-doctoral fellow's sponsor would determine the "specific nature" of her duties.

Several factors indicate that the Taxpayer exercised financial control over these workers. First, Taxpayer required post-doctoral fellows to devote their research services to helping it fulfill its particular contractual obligations to the granting agency. Taxpayer was not purchasing services that the fellows otherwise made available to the public. Second, appointment letters indicated that the Taxpayer compensated these post-doctoral fellows whether or not they completed the tasks that they were assigned. Thus, they were being paid wages for spending time working toward a research result rather than being paid for the result itself. Third, the Taxpayer prepared budget requests and justifications, indicating that it controlled the research projects' budgets. Fourth, they were paid a flat stipend for the year of service with no potential for financial gain or risk of financial loss based on the outcome of their work. Further, it does not appear that the post-doctoral fellows had the authority to make decisions that affected their "bottom line"; their stipends were set at the time they were appointed, and they had no ability to vary the amount they were paid by controlling the costs of their research.

Finally, the Taxpayer's relationship with these non-NRSA post-doctoral fellows bore substantial indicia of a traditional employer-employee relationship. For example, appointment letters offered appointees specific compensation in exchange for specific research services. The Taxpayer also provided these post-doctoral fellows with fringe benefits, which could include retirement benefits. By contrast, HHS prohibited the Taxpayer from using NRSA payments to fund post-doctoral fellows' retirement plans.

Given the nature of scientific research and the timing of experiments, non-NRSA fellows may have had latitude to set their schedules to suit the research to be performed. As professionals with graduate degrees, they may have been accorded respect and independence in conducting their research, both as to how to go about it, and what tools or equipment they might use. The specific research techniques they were using and the tasks they were performing may have been similar to those the NRSA fellows were pursuing. However, the parameters of the research to be done by the non-NRSA fellows were set by the supervisors, and the research itself was monitored and evaluated by the supervisors. Even if a fellow collaborated with a supervisor to design a research project and submit a grant to fund it, the supervisor had to put himself forward as the leader of the project and attest to the accuracy of the project's application for funding. The Taxpayer does not dispute that the supervisor is an employee so even if a fellow were taking a substantial role in designing the research project to be conducted, he or she would be similarly situated to the supervisor in that respect. Also, an examination of these research efforts' published results indicates that the articles would typically list the principal investigator along with the research fellows. The research is performed using the Taxpayer's facilities, tools and equipment (some of which is very expensive). There are other similarities between the NRSA and non-NRSA payments on some discreet details, such as the receipt of vacation time, sick time, and health insurance. However, the distinctions between the two types of fellows remain substantial on the key factors used to determine their classification for FICA purposes. In sum, the fellows had an employment relationship with the Taxpayer.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[REDACTED]

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Please contact Syd Gernstein or Neil D. Shepherd at (202) 622-6040 if you have any further questions.