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The Impossible Student Exception to FICA Taxation and Its Applicability to Medical Residents

Patrick Timothy Rowe

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The Impossible Student Exception to FICA Taxation and Its Applicability to Medical Residents

Patrick Timothy Rowe*

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* Candidate for J.D., Washington and Lee University School of Law, May 2010. President George W. Bush once bemoaned: "They want the federal government controlling Social Security like it's some kind of federal program." I find great inspiration in these words.

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I. Introduction

An employee who is otherwise required to pay Social Security taxes under the Federal Insurance Contributions Act of 1954 (FICA)¹ may be exempt if the employee's compensation is received as remuneration for "service[s] performed in the employ of . . . a school, college, or university . . . [and] if such service is performed by a student who is enrolled in and regularly attending classes at such school, college, or university."² The federal courts have been inconsistent in determining whether medical residents' stipends fall under these "student" exemptions.³ These conflicting rulings have been the result of differing analytical approaches,⁴ creating not only unequal treatment under the Internal Revenue Code, but also an unfair burden on taxpayers as they attempt to anticipate how a particular federal court will rule on this issue. Since 1998, there have been over 7,000 claims seeking refunds of FICA tax contributions; the total amount claimed in these refund suits well exceeds \$1 billion.⁵ While

1. See Federal Insurance Contributions Act of 1954, 26 U.S.C. §§ 3101–3128 (2000) (imposing additional taxes on employees and employers for purposes of contributing to the Social Security and welfare systems).

2. *Id.* § 3121(b)(10).

3. Compare *Minnesota v. Apfel*, 151 F.3d 742, 748 (8th Cir. 1998) (applying factual inquiry into nature of relationship of medical residents with university and affirming district court's ruling that medical residents met requirements for student exclusion), and *United States v. Mayo Found. for Med. Educ. & Research (Mayo I)*, 282 F. Supp. 2d 997, 1019–20 (D. Minn. 2003) (finding student exclusion applicable to medical residents at all of Mayo's various institutions, and ordering refund by United States of monies paid pursuant to FICA tax), with *United States v. Detroit Med. Ctr.*, No. 05-71722, 2006 WL 3497312, at *1 (E.D. Mich. Dec. 1, 2006) (finding statute and applicable regulations ambiguous, requiring review of statutory and legislative history), and *Albany Med. Ctr. v. United States*, No. 1:04-CV-1399, 2007 WL 119415, at *5 (N.D.N.Y. Jan. 10, 2007) ("[A]s a matter of law, medical residents continue to be subject to FICA taxes today because they do not qualify for the student exemption of . . . § 3121(b)(10).").

4. Compare *Apfel*, 151 F.3d at 748 (adopting a case-by-case analysis for determining the nature of residents' employment relationships with their university), and *Mayo Found. for Med. Educ. & Research v. United States (Mayo II)*, 503 F. Supp. 2d 1164, 1172 (D. Minn. 2007) (finding "student exclusion" provision of § 3121 "not complicated or filled with technical language, but . . . straightforward"), with *Detroit Med. Ctr.*, 2006 WL 3497312, at *8 (finding the language of "student exclusion" provision ambiguous and requiring judicial review of statutory and legislative history to determine legislative intent).

5. *United States v. Mount Sinai Med. Ctr. of Fla., Inc.*, 353 F. Supp. 2d 1217, 1229 (S.D. Fla. 2005).

medical residents may not be affected significantly by this issue as individuals,⁶ hospitals and other similar organizations remain vulnerable as they must "match" all employee FICA contributions.⁷ Ambiguity in this area of tax law constitutes a difficult obstacle for taxpayers in the medical community.

This Note will address the unique characteristics of, and current tensions between, tax law, the Social Security system, and the various processes employed by the federal courts, all of which have led to such ambiguities. Part II will introduce the two divergent approaches employed by the federal courts in deciding whether medical residents qualify for the student exemption, identifying those analytical tools which should be salvaged, and those which were either improperly employed or are simply irrelevant to the dispute in question. Part III will review briefly the history of the current Social Security system and related statutes and regulations, focusing on the development of the student exception under § 3121(b)(10).⁸ In this context, Part IV will discuss how tax law presents several practical problems and internal inconsistencies

6. An initial question arises as to whether medical residents seeking exemption from FICA taxation under § 3121(b)(10) would nevertheless be liable for self-employment taxes under 26 U.S.C. § 1401. *See* 26 U.S.C. § 1401 (2000) (imposing a tax on the self-employment income of every individual for purposes nearly identical to those associated with FICA taxes). If not, qualifying residents would be exempt *in toto* from any sort of tax contribution to the Social Security and welfare systems; if so, the institutions sponsoring the residents would not be required to withhold taxes from their residents' stipends (and thus would not be required to match those employee contributions as employers), but the residents themselves would be required to contribute at double the rate of taxation. *Compare id.* §§ 1401(a)–(b) (stating that beginning December 31, 1989, the rate of taxation under § 1401 for self-employment income became 11.4%, plus an additional 2.9% for hospital insurance), *with id.* §§ 3101(a)–(b) (stating that employees are taxed at a rate of 6.2%, plus an additional 1.45% for hospital insurance), *and id.* §§ 3111(a)–(b) (stating that employers are taxed at a rate of 6.2%, plus an additional 1.45% for hospital insurance). It seems, however, that qualification under § 3121(b)(10) would not expose medical residents to self-employment tax liability. In this case, the applicability of § 1401 turns on a close reading of § 1402(c), specifically in relation to the term "trade or business" and whether it contemplates taxpayers who qualify under § 3121(b)(10). *See id.* § 1402(c) ("The term 'trade or business' . . . when used with reference to self-employment income or net earnings from self-employment . . . shall not include . . . the performance of service by an individual as an employee, *other than* [certain limited exceptions of § 3121(b)]." (emphasis added)). Section 1402(c)'s enumeration of the § 3121(b) exclusions which are *not* to be excluded from the definition of "trade or business" must be read as an exhaustive list, and § 3121(b)(10) does not appear on that list. Therefore, income gained by medical residents in the employ of their sponsoring institution does not derive from the residents' "trade or business," and medical residents falling under § 3121(b)(10) will not be viewed as "self-employed" for purposes of § 1401 taxation.

7. *See* 26 U.S.C. § 3111 (2000) ("[T]here is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages . . . paid by him with respect to employment.") (emphasis added).

8. *See* 26 U.S.C. § 3121(b)(10) (2000) (stating the student exception to FICA taxation).

which render resolution of disputed tax issues more difficult than in many other areas of law.

Part V of the Note will argue that the Internal Revenue Service (IRS) should view graduate medical education programs (GMEs) in the United States as institutions of higher education, and view their medical residents as students because, as a practical matter, the relationship between medical residents and their sponsoring institutions is one based on the pursuit of medical education. Part VI will propose a framework to resolve these tax issues, balancing law, policy, and economics to reconcile the principle considerations of tax scholarship. Specifically, this Part will argue that the IRS's attempts to disqualify residents from the student exception contravene Congressional intent and that the federal courts' further reliance on a "case-by-case" standard of review is unnecessary. Accordingly, GME programs and their medical residents should be afforded the presumption of qualification under the student exception of § 3121(b)(10).

II. Approaches Employed by the Federal Courts

The heart of this dispute turns on the appropriate interpretation of the student exclusion. That is, whether the statute can be read as ambiguous, thus requiring a review of statutory history.⁹ Two prominent federal cases represent the current dichotomy in this area of the law: *Minnesota v. Apfel*¹⁰ and *United States v. Detroit Medical Center*.¹¹ A discussion of these and related cases follows.

A. The Majority Approach: *Minnesota v. Apfel*

In 1955, the State of Minnesota entered into a "section 218" agreement¹² with the federal government to extend Social Security coverage to a select

9. See *United States v. Detroit Med. Ctr.*, No. 05-71722, 2006 WL 3497312, at *11 (E.D. Mich. Dec. 1, 2006) (arguing that because the "student exclusion" provision is ambiguous, "[e]xtrinsic materials have a role in statutory interpretation only to the extent they shed a reliable light on the enacting Legislature's understanding of otherwise ambiguous terms" (quoting *Exxon Mobile Corp. v. Allapattah Servs.*, 545 U.S. 546, 568 (2005))).

10. See *Minnesota v. Apfel*, 151 F.3d 742, 747-48 (8th Cir. 1998) (finding the student exclusion provision of Minnesota's Section 218 agreement with the federal government applicable to the University of Minnesota's medical residents).

11. See *Detroit Med. Ctr.*, 2006 WL 3497312, at *8 (finding that medical residents were, as a matter of law, not "students" for purposes of FICA's student exemption provision).

12. In its early stages, the Social Security Act was inapplicable to state government

group of its state government employees.¹³ This agreement was modified in 1958 to extend coverage to "[s]ervices performed by individuals as employees' of the University of Minnesota."¹⁴ Additionally, the modification provided an exclusion for "[a]ny service performed by a student."¹⁵ Perhaps the most important aspect of the court's analysis is its adoption of a case-by-case analysis for determining the applicability of the student exemption to residents at the University of Minnesota: "The Commissioner cannot avoid . . . a case-by-case examination by summarily concluding that medical residents are never students regardless of the nature of their employer."¹⁶ This case-by-case approach has become the main vehicle through which GME programs and their medical residents have succeeded in challenging FICA liability over the past several decades.¹⁷

1. Background and Holding

Understanding the student exemption to include those stipends received by medical residents from their university, the State of Minnesota did not withhold Social Security contributions for nearly forty years,¹⁸ a practice that was finally challenged in 1990 when the Social Security Administration assessed a deficiency for unpaid contributions relating to resident stipends.¹⁹ After an unsuccessful administrative review of this assessment, Minnesota appealed to the district court for a redetermination.²⁰ The court granted summary judgment in favor of Minnesota on two alternative holdings: First, that under the 1958 modification, residents were not classifiable as "employees" under the Section

employees; however, Section 218 of the Social Security Act (codified at 42 U.S.C. § 418) enabled states to contract with the federal government through a formal agreement, thereby affording such employees coverage, with the option of withdrawing from the program. See Thomas W. Merrill, *The Landscape of Constitutional Property*, 86 VA. L. REV. 885, 940 (2000) (discussing Section 218 in the context of a challenge to the repeal of employees' "withdrawal rights" as an unconstitutional taking of property).

13. *Apfel*, 151 F.3d at 744.

14. *Id.*

15. See *id.* (noting this modification's compliance with 42 U.S.C. § 418(c)(5) (2000)).

16. *Id.* at 748.

17. See *infra* note 107 and accompanying text (identifying federal courts which have employed the *Apfel* approach).

18. *Minnesota v. Apfel*, 151 F.3d 742, 744 (8th Cir. 1998).

19. See *id.* (noting the Social Security Administration's assessment of roughly \$8 million in unpaid Social Security contributions).

20. See *id.* ("Both the State and the Commissioner [of the Social Security Administration] filed motions for summary judgment.").

218 agreement for purposes of contribution to Social Security; and second, that even if residents could be classified as employees, the student exclusion incorporated in the 1958 modification applied to the medical residents.²¹ The Administration appealed.²²

The Court of Appeals for the Eighth Circuit reviewed both of the district court's alternative holdings.²³ The court's analysis of the residents' "employee" status focused on the nature of the Section 218 agreement between Minnesota and the Administration, specifically whether such an agreement constituted a contract or "merely written evidence that [Minnesota had] exercised its statutory option to participate in the Social Security program."²⁴ The Administration relied upon the Supreme Court's decision in *Bowen v. Public Agencies Opposed to Social Security Entrapment*,²⁵ arguing that, as a result of *Bowen's* holding, Section 218 agreements did not create a Fifth Amendment property interest in the right to withdraw from the program, and that the Section 218 agreement with Minnesota, thus, did not constitute a contract.²⁶ The appeals court rejected this argument, pointing out *Bowen's* numerous references to "contractual agreements" and its obvious assumption that Section 218 agreements were indeed contracts.²⁷ The Eighth Circuit affirmed the lower court's finding that the parties did not intend to include medical residents in the 1958 coverage extension modification.²⁸

The Eighth Circuit also agreed with the district court's alternative holding that, even if medical residents were properly considered "employees," the residents' stipends were nevertheless exempt under the student exclusion incorporated in the 1958 modification.²⁹ The court focused on the nature of the

21. *Id.* at 744–45.

22. *Id.* at 745.

23. *Id.* at 745–49.

24. *Id.* at 746.

25. *See Bowen v. Pub. Agencies Opposed to Soc. Sec. Entrapment*, 477 U.S. 41, 54–56 (1986) (holding that Congress's reservation of the right to alter terms of Section 218 agreements with contracting states was constitutional).

26. *See Minnesota v. Apfel*, 151 F.3d 742, 746 (8th Cir. 1998) ("The [*Bowen*] Court concluded that because Congress had expressly reserved the power to amend section [2]18, it also retained concurrent power to affect the terms of agreements entered into pursuant to that section."). The Social Security program was designed to last for an indefinite period of time, and given the difficulties in accurately predicting future economic conditions, Congress contemplated a flexible system. *Flemming v. Nestor*, 363 U.S. 603, 610 (1960).

27. *Apfel*, 151 F.3d at 746.

28. *Id.* at 745 n.7 (discussing evidence upon which the district court relied when determining the intent of the contracting parties).

29. *See id.* at 747 (finding residents' "primary purpose" for enrolling in the university was educational, not for purposes of employment).

relationship between the university and its medical residents.³⁰ Arguing that the Eighth Circuit's holding in *Rockswold v. United States*³¹ required a finding that stipends received by medical residents were in the nature of compensation for services rendered,³² the Administration contended that the residents' "primary purpose" was to earn income rather than receive an education.³³ The court rejected this argument, stating "[t]he fact that payments received by the residents constitute taxable income does not mean the primary purpose of their relationship with the University is not educational."³⁴ Highlighting that residents paid tuition and were enrolled in classes, the Eighth Circuit found no dispute that the residents' primary purpose was to obtain an education, and, therefore, application of the student exclusion was proper.³⁵

2. Analysis of the Student Exception: How Does Apfel Play Out Today?

While a majority of federal courts have employed the *Apfel* approach,³⁶ the opinion ultimately focused on contract interpretation and a review of the student exception as it existed within the four corners of the Section 218 agreement between Minnesota and the federal government.³⁷

30. *Id.* at 747.

31. See *Rockswold v. United States*, 620 F.2d 166, 169 (8th Cir. 1980) (affirming the district court's determination that stipends properly are included in medical residents' gross income for income taxation purposes).

32. *Minnesota v. Apfel*, 151 F.3d 742, 747 (8th Cir. 1998).

33. *Id.* In *Rockswold*, the issue was whether, for federal income tax purposes, medical residents should be permitted to exclude stipends from their gross income on the theory that stipends constituted non-taxable scholarships or grants. *Rockswold*, 620 F.2d at 167–68. The *Rockswold* court focused on the nature of the payments to the residents, as opposed to the relationship between the school and the resident. See *id.* at 169 ("The fact that the services provided required only a portion of the medical fellows' time is not controlling. The threshold question is whether the payment was made as quid pro quo for the services rendered." (citing *Bingler v. Johnson*, 394 U.S. 741 (1969))).

34. See *Apfel*, 151 F.3d at 747 ("[W]e noted [in *Rockswold*] that the University's residency program 'is designed to educate and train physicians so that they can pursue careers in academic medicine and medical research.'" (quoting *Rockswold*, 620 F.2d at 167)).

35. *Id.* at 748. The court also rejected the Administration's argument that a Social Security Ruling—which declared that medical residents were not students—should control the court's interpretation of the term "student." *Id.* The court found that ruling inconsistent with applicable regulations calling for a case-by-case analysis of the relationship between the student and the educational institution. *Id.* (citing 20 C.F.R. § 404.1028(c)).

36. See *infra* note 107 and accompanying text (noting one court's reference to a majority of federal courts using the *Apfel* approach in determining applicability of student exception to medical residents).

37. As noted above, the court made numerous references to the contractual nature of the

The court noted, however, that the language of 42 U.S.C. § 418(c)(5) (the codification of the student exception found in Section 218 agreements) made reference to the general student exclusion in the Social Security Act, as amended through 1984.³⁸ The similarities between the language of the Section 218 agreement and the current student exception under § 3121(b)(10)³⁹ have enabled courts in recent decisions to rely upon *Apfel*'s examination of student exemptions in the Internal Revenue Code.⁴⁰

The *Apfel* opinion remains good law; however, the court's "student exception" analysis is thin, likely due in part to the court's initial holding that the parties intended to exclude medical residents from Social Security coverage via contract.⁴¹ The substance of the case-by-case approach has developed primarily through subsequent federal court decisions handling this issue, most thoroughly in Judge Richard H. Kyle's⁴² 2003 opinion in

Section 218 agreement, and the Commissioner's primary contention was that because the agreement was not contractual in nature, the parties' intent at the time when the agreement was entered into was irrelevant. *Id.* at 745. It is *Apfel*'s alternative holding which has motivated various other GME programs to file refund suits claiming repayment of previously withheld FICA taxes in relation to their medical residents.

38. *Id.* at 747; see also 42 U.S.C. § 410(a)(10) (1982 & Supp. II 1984) (providing language identical to the current student exception under 26 U.S.C. § 3121(b)(10) (2004)).

39. See, e.g., *United States v. Detroit Med. Ctr.*, No. 05-71722, 2006 WL 3497312, at *7 (E.D. Mich. Dec. 1, 2006) (appreciating strong similarities between language of the Section 218 agreement and § 3121(10)(b), and between 20 C.F.R. § 404.1028(c) and Treas. Reg. § 3121.3121(b)(10)-2(b) & (c)).

40. See, e.g., *Univ. of Chi. Hosps. v. United States*, 545 F.3d 564, 570 (7th Cir. 2008) (holding that the student exception under § 3121(b)(10) unambiguously did "not categorically exclude medical residents from eligibility"); *Mayo Found. for Med. Educ. & Research v. United States*, 503 F. Supp. 2d 1164, 1176 (D. Minn. 2007), *appeal docketed*, No. 07-3242 (8th Cir. Sept. 8, 2007) (rejecting Government's attempts to draw bright-line rule disqualifying medical residents for the student exception as in conflict with *Apfel*'s case-by-case approach); *Ctr. for Family Med. v. United States*, 456 F. Supp. 2d 1115, 1117 (D.S.D. 2006) ("The court finds . . . that the law in the Eighth Circuit prohibits such a bright line rule." (citing *Minnesota v. Apfel*, 151 F.3d 742, 748 (8th Cir. 1998))); *United States v. Mayo Found. for Med. Educ. & Research*, 282 F. Supp. 2d 997, 1010 (D. Minn. 2003) (affirming the case-by-case analysis established in *Apfel*).

41. The *Apfel* court notes that while related administrative rulings may be entitled to deference, they are not binding and "courts will not defer to rulings that are 'plainly erroneous or inconsistent with the Act or regulations.'" *Apfel*, 151 F.3d at 748 (quoting *Chavez v. Dept. of Health & Human Servs.*, 103 F.3d 849, 851 (9th Cir. 1996)). On several occasions, the Government has unsuccessfully challenged the "student exception" holding in *Apfel* as non-binding *dictum* by the Eighth Circuit. See *Ctr. for Family Med. v. United States*, 456 F. Supp. 2d 1115, 1119 (D.S.D. 2006) (holding that a binding, alternative holding is not *dictum*) (citing *Brazzell v. United States*, 788 F.2d 1352, 1357 n.4 (8th Cir. 1986)); *United States v. Detroit Med. Ctr.*, No. 05-71722, 2006 WL 3497312, at *7 (E.D. Mich. Dec. 1, 2006) (same).

42. The Honorable Richard H. Kyle sits in senior status as a Judge for the United States District Court for the District of Minnesota. Judge Kyle has authored two of the more

United States v. Mayo Foundation for Medical Education and Research (Mayo I).⁴³

3. Mayo I

The facts in *Mayo I* are essentially identical to those in *Apfel*, with the exception that the Mayo Foundation is a private organization and is, therefore, required to withhold taxes under FICA.⁴⁴ The principal focus of Judge Kyle's analysis was the language of § 3121(b)(10) itself, specifically if, as the Government argued, the provision was ambiguous as to whether Mayo's residents might be covered by a plain reading of the statute.⁴⁵ Without his own independent review of the statute, Judge Kyle found this argument unpersuasive.⁴⁶ After a brief review of the Eighth Circuit's opinion in *Apfel*,⁴⁷ the court immediately turned to § 3121(b)(10)'s implementing regulations to determine the student exception's applicability to the Mayo residents.⁴⁸

prominent opinions pertaining to the issue discussed in this Note. See generally *Mayo Found. for Med. Educ. & Research v. United States (Mayo II)*, 503 F. Supp. 2d 1164 (D. Minn. 2007); *United States v. Mayo Found. for Med. Educ. & Research (Mayo I)*, 282 F. Supp. 2d 997 (D. Minn. 2003).

43. See *Mayo I*, 282 F. Supp. 2d at 1010 (holding student exception applicable to Mayo Foundation's medical residents).

44. See *supra* note 12 and accompanying text (noting the prior mechanism for extending Social Security coverage to state employees).

45. See *Mayo I*, 282 F. Supp. 2d at 1007 ("[T]his case presents the narrow question of whether an *express* exemption set forth in FICA *applies* to the individuals who served as residents at Mayo."). "The question . . . is one of statutory intent, and we accordingly begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose." *Id.* (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 383 (1992)). Note the important distinction: Judge Kyle chose not to address the question of whether § 3121(b)(10) is, on its face, ambiguous, but instead turned directly—and perhaps prematurely—to the statute's applicable regulations.

46. See *id.* (finding simply that the Government had failed to provide any significant support that § 3121(b)(10) possessed anything other than what a plain reading of the statute yielded).

47. *Id.* at 1009–10.

48. See *id.* at 1010–11 (adopting the two part test prescribed by 26 C.F.R. § 31.3121(b)(10) for exception qualification). The court stated:

Defendants must . . . show that "the character of the organization in the employ of which the services [were] performed [was] a school, college, or university . . ." and . . . that the residents were "enrolled and regularly attending classes at the school, college, or university by which [they were] employed or with which [their] employer is affiliated."

Id. at 1010 (quoting Treas. Reg. §§ 31.3121(b)(10)-1(b)(1)-(2) (2003)).

Finding that the Mayo Foundation was the common-law employer of the medical residents⁴⁹ and that Mayo's several institutions properly were considered a "school, college, or university" for purposes of the exception,⁵⁰ Judge Kyle turned to the question of whether the Mayo residents qualified as "students" as contemplated by the statute.⁵¹ The court relied on several distinct characteristics of the Mayo Foundation to find that, in the context of its relationship with the residents, the GME programs were educational in nature.⁵² Specifically, the court noted that admission to the program was entirely merit-based⁵³ and that residents were required to participate in daily teaching rounds in addition to classroom attendance.⁵⁴ Former residents also testified at trial that when they had matriculated into Mayo, they had no expectation of employment subsequent to completion of their degree program,⁵⁵ the stipends were not a significant incentive for their interest in the program,⁵⁶ and that their purpose for enrollment was to obtain specialized skill and knowledge in their medical field of study.⁵⁷ The Government also challenged Mayo's exemption status on the basis that the patient care provided by these residents was not "for the purpose of and incidental to pursuing a course of study."⁵⁸ The court rejected this argument, noting that "[t]ime alone cannot be the sole measure of the relationship between services performed and a course of study."⁵⁹

49. *See id.* at 1011–13 (discussing the Mayo Foundation's influence over the medical residents and finding that the foundation was the residents' employer).

50. *See id.* at 1013–15 (rejecting Government's "primary purpose" test for determining whether an institution qualified under the exemption and finding the "Mayo Foundation, a nonprofit, charitable, tax-exempt institution, constitute[s] a 'school, college, or university' for purposes of § 3121(b)(10)").

51. *Id.* at 1015.

52. *Id.*

53. *Id.*

54. *See id.* at 1017 (noting that while the residents were not registered for credit hours, the well-defined subject areas covered by the GME program with evaluations based on grades to be recorded on official transcripts was sufficient to characterize the residents as "regularly attending classes").

55. *Id.* at 1008 n.8.

56. *See id.* at 1017 (noting former residents' testimony that "their purpose in enrolling in a residency program . . . was educational—to gain the knowledge and skill necessary to practice in a specialty area of medicine" and that they "were not attracted to . . . residency programs because of the stipend") (citations omitted).

57. *Id.*

58. *See id.* ("[T]he United States contends [that] Mayo residents were working in hospitals and clinics between fifty and eighty hours per week, an activity that dominated any 'course of study' being pursued.").

59. *Id.* at 1018. "The learning process on clinical rotations consisted largely of residents

Accordingly, the court held that Mayo's medical residents (and their stipends) qualified for the student exception of § 3121(b)(10).⁶⁰

Judge Kyle's discussion of Mayo's established curriculum,⁶¹ mandatory attendance at educational lectures and conferences,⁶² and the administration of written, graded examinations⁶³ illustrates the general nature of GME programs in the United States.⁶⁴ In addition, and perhaps most important to the analysis, Judge Kyle noted Mayo's "learning by doing" method of instructing its residents via teaching rounds and patient care.⁶⁵ Applying the regulation's two-part test to these characteristics of the Mayo GME programs,⁶⁶ the court addressed the following two issues: the applicability of § 3121(b)(10) to Mayo residents⁶⁷ and whether the residents were "students" as contemplated by the exception.⁶⁸

making *suggestions* to the staff physicians and the staff physicians *correcting* the residents." *Id.* (emphasis added).

60. *Id.* at 1019–20.

61. *Id.* at 1002.

62. *Id.* at 1004.

63. *See id.* ("Transcripts for residents . . . bear letter grades for each completed rotation in a given subject area.") (citations omitted).

64. *See infra* Part V (discussing in detail the characteristics of American GME programs).

65. *United States v. Mayo Found. for Med. Educ. & Research (Mayo I)*, 282 F. Supp. 2d 997, 1003 (D. Minn. 2003).

66. *See supra* note 48 and accompanying text (referencing the court's acknowledgment of treasury regulation § 31.3121(b)(10)'s two-part test). As an initial matter, Judge Kyle addressed the Government's familiar argument that the student exception was, as a matter of law, unavailable to the medical residents. *Mayo I*, 282 F. Supp. 2d at 1005–06. In support of this argument, the Government relied upon the repeal of the medical intern exception as evidence that Congress intended "to bring all young doctors-in-training within the scope of Social Security coverage and, hence, FICA taxation." *Id.* at 1006. This argument was first addressed—and rejected—by the District Court for the District of Minnesota in *Minnesota v. Chater*. *Minnesota v. Chater*, No. 4-96-756, 1997 U.S. Dist. LEXIS 7506, at *9–10 (D. Minn. May 21, 1997), *aff'd sub nom.* *Minnesota v. Apfel*, 151 F.3d 742 (8th Cir. 1998). As the court had ruled previously, Judge Kyle found this argument unpersuasive. *Apfel*, 151 F.3d at 1007. *But see* *United States v. Mount Sinai Med. Ctr.*, 353 F. Supp. 2d 1217, 1222 (S.D. Fla. 2005) (believing that, when it repealed the intern exception, "[i]f Congress had intended to include residents and interns within the student exception, Congress would likely have stated that it was overruling *St. Luke's*.") (citations omitted).

67. *See Mayo I*, 282 F. Supp. 2d at 1010–15 (identifying the residents' actual "employer" and reviewing that employer's status as a "school, college, or university").

68. *See id.* at 1015–18 (reviewing "enrollment," "regular class attendance," "residents' purpose" for involvement in GME program, and the nature of their services as factors in determining status as "students").

a. Applicability of the Student Exception to Mayo Residents

The court first addressed the issue of whether the organization qualified as a "school, college or university" (SCU)⁶⁹ under treasury regulation § 3121(b)(10)-2(d), which stated: "The term 'school, college, or university' within the meaning of this section is to be taken in its commonly or generally accepted sense."⁷⁰ Responding to Mayo's request that the court look to dictionary definitions in interpreting "SCU,"⁷¹ the Government pointed to other provisions in the Internal Revenue Code and their implementing regulations using language roughly similar to that found in § 3121(b)(10), arguing that because those sections required the application of a "primary purpose" test, so should the student exception under § 3121(b)(10).⁷² The court was not persuaded, positing that had the IRS intended for these phrases to be interpreted identically (or at least similarly), the Service could have referenced such provisions in the regulations relating to the student exception.⁷³

One of the Government's strongest arguments was evidence of Mayo's operating expenditures: Over three-quarters of the Foundation's overall expenses related to patient care, while roughly five percent related to education and clinical support.⁷⁴ Therefore, according to the Government, Mayo's GME programs could not reasonably be characterized as having an "educational" purpose. Again, Judge

69. *Id.* at 1013–15. Of course, if the court had found that the Mayo Foundation was outside the definition of this term, any further inquiry into the matter would have been meaningless.

70. 26 C.F.R. § 31.3121(b)(10)-2(d) (2003).

71. *United States v. Mayo Found. for Med. Educ. & Research (Mayo I)*, 282 F. Supp. 2d 997, 1013 (D. Minn. 2003).

72. *See id.* ("The United States challenges the Defendants' recourse to dictionary definitions, arguing that the proper test for evaluating whether an organization is a 'school, college, or university' is the identification, through objective evidence, of the organization's 'primary purpose.'"). Compare 26 U.S.C. § 3121(b)(10) (2000) (relating to "school, college, or university"), with *id.* § 170(b)(1)(A)(ii) (relating to charitable contributions and gifts using language of "educational institution"), and *id.* § 151(c)(4)(A) (relating to deductions for personal exemptions using language of "educational organization").

73. *Mayo I*, 282 F. Supp. 2d at 1013. It is worth noting the court's failure to address this issue from the perspective of Congress. That Congress used different language in § 3121(b)(10) could be interpreted as evidence of Congress's intent to draw a meaningful distinction. That is, § 151 and § 170 of title 26 deal with deductions from individual, taxable *income*, whereas §§ 3101–3128 pertain to FICA taxation. Federal income tax statutes represent Congress's exercise of taxation and spending powers; FICA tax statutes are merely the means by which the Social Security Administration funds its OASDI and welfare programs—the two are entirely separate and distinct. Arguably, Congress intended the FICA student exception to have broader applicability than the education-related deductions found within the Tax Code's revenue provisions.

74. *Mayo I*, 282 F. Supp. 2d at 1014 & n.32.

Kyle rejected the Government's position, noting that "the Foundation could provide patient care far more cost-effectively *without* residents because of the time and effort required to supervise them. The Foundation's financial statements establish that [for the years at issue] the Foundation had negative net revenue from patient care."⁷⁵ And loss of revenue from patient care makes sense in the context of GME programs at teaching hospitals. The study of specialized medicine requires something other than traditional, parochial approaches to education. Simply put, classroom lectures and textbook assignments, while undoubtedly important aspects of a resident's professional and scholastic development, alone would likely prove ineffective. It is therefore unsurprising that GME programs place significant emphasis on kinesthetic learning, often to the detriment of the umbrella or parent organization's profitability.⁷⁶ "Because the objective of residency programs is ultimately to make physicians capable of caring for patients twenty-four hours a day and seven days a week, it is impossible to separate 'education' from 'patient care.'"⁷⁷ Assuming such an objective to be the overarching goal of American GME programs, it is impossible not to recognize interconnectivity between these programs' education and patient care "departments." Compartmentalizing expenses and drawing departmental lines is unnatural in the context of GME programs and only serves to avoid a realistic analysis of their true nature and function. As Judge Kyle pointed out in *Mayo I*, the proverbial classroom "must be the clinical setting because patient care in a medical specialty is what residents are receiving training for."⁷⁸ Accordingly, the court found that Mayo qualified as an SCU.⁷⁹ Judge Kyle then turned his attention to the Mayo residents.

75. *Id.* at 1014. Profitability alone, however, is not a reliable standard by which to determine an organization's purpose. The net operating loss associated with Mayo's patient care is one of several indicia showing that the Foundation is concerned with issues other than turning a profit. The court's logic is that the "other issue" here must be the provision of quality education.

76. *See infra* notes 193–96 and accompanying text (reviewing accreditation standards imposed on GME programs which tend to limit maximum work hours).

77. *United States v. Mayo Found. for Med. Educ. & Research (Mayo I)*, 282 F. Supp. 2d 997, 1015 (D. Minn. 2003).

78. *Id.*

79. *Id.*

b. Were the Residents "Students"?

Concerning whether the residents qualified as "students," the regulation stated that "the status of the employee as a student performing the services shall be determined on the basis of the relationship of such employee with the organization for which the services are performed."⁸⁰ This relationship consisted of four elements: enrollment, regular attendance, residents' purpose for participating, and rendering services as an incident to and for the purpose of pursuing a course of study.⁸¹ Again, the court used the *Apfel* case-by-case approach in concluding that the relationship between Mayo and its residents possessed all of these elements. Specifically, the court found that admittance into the Mayo Graduate School of Medicine was based entirely on merit and that the admissions process was fairly typical and determined that these facts suggested that residents were "enrolled" as opposed to hired or contracted-for.⁸² The court also believed Mayo's various educational conferences, regularly scheduled teaching rounds, and mandatory lecture attendance were sufficient factors establishing that residents "regularly attended classes."⁸³ Regarding the residents' purpose in participating in the GME programs, the court rejected the Government's assertion that residency was nothing more than "on-the-job training."⁸⁴ "The former residents . . . consistently and credibly testified that their purpose in enrolling in a residency program at Mayo was educational—to gain the knowledge and skill necessary to practice in a specialty area of medicine."⁸⁵ This, coupled with Mayo's "highly structured curricula," was enough to establish an educational purpose for residents' enrollment.⁸⁶ Lastly, the Government challenged the Mayo-resident relationship on the basis that the

80. 26 C.F.R. § 31.3121(b)(10)-2(c) (1996); *see also* 26 C.F.R. § 31.3121(b)(10)-2(d) (2009) (providing for same inquiry).

81. *Mayo I*, 282 F. Supp. 2d at 1015 (D. Minn. 2003). The court analyzed each of these elements independently. *Id.* at 1015–18.

82. *Id.* at 1015–16.

83. *See id.* at 1016–17 (rejecting the Government's argument that a minimum attendance requirement was essential to the element of "regularly attending classes"). The court also noted that the language of the regulation did not require that the student receive a degree for his studies; rather, it need only be shown that the student be in pursuit of a course of study, regardless of the eventuality of a degree. *Id.* at 1016.

84. *Id.* at 1017.

85. *Id.*; *see also id.* at 1001 n.8 ("Former residents [also] testified that, when they began their residencies, they had *no* expectation of being hired by the Foundation as a staff physician upon completion of their program.").

86. *Id.* at 1017. The Government also suggested that because residents engaged in "moonlighting," they were fully capable of independent patient care. *Id.* The court disagreed: Moonlighting was a source of income, not a training exercise. *Id.*

substantial quantum of work which residents performed in the hospitals—in some cases, upwards of eighty hours—necessarily dominated any "pursuit of a course of study."⁸⁷ Not only did this argument fail to acknowledge the close nexus between patient care and resident education,⁸⁸ the court found that care provided by residents in the outpatient setting was subject to the review and approval of staff physicians on duty.⁸⁹ In the aggregate, the court found these facts determinative of an educational relationship between Mayo and its residents, and that, based on a fair and plain reading of the regulations, Mayo residents were "students" for purposes of the exception.⁹⁰

4. *What of These Opinions Should Survive?*

The courts in both *Apfel* and *Mayo I* believed that review of legislative history relating to the student exception was unnecessary. In their view, the language of both § 3121(b)(10) and its implementing regulations was sufficiently unambiguous such that resort to congressional evidence of intent for terms like SCU or "student" was unwarranted.⁹¹ *Mayo I*, however, displays a key flaw on this point. Under generally accepted principles of administrative law, a court should ask two questions when reviewing agency construction of a statute which Congress has empowered that agency to administer: on the precise question at issue, is Congress's intent clear; and if not, is the agency's construction of the statute permissible.⁹² If Congress's intent is clear and unambiguous, no further analysis is required.⁹³ Courts will look to an agency's

87. See *id.* at 1018 (noting that most patients were seen by residents and the cost of those services could be billed to Medicare and third parties).

88. See *supra* notes 76–78 and accompanying text (discussing the interconnectivity between educational goals and medical practice).

89. See *United States v. Mayo Found. for Med. Educ. & Research (Mayo I)*, 282 F. Supp. 2d 997, 1018 (D. Minn. 2003) (quoting a Mayo resident's testimony regarding the supervisory nature of the clinical training aspect of the GME program). "[T]he whole time that you are a resident, there is someone looking over your shoulder that's responsible for what you do." *Id.* (emphasis omitted).

90. *Id.*

91. See *supra* notes 45–48 and accompanying text (noting that in reviewing § 3121(b)(10)'s implementing regulations, the courts necessarily found the statute ambiguous as to whether medical residents qualified for the exception).

92. *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842 (1984).

93. See *id.* at 842–43 ("[T]he court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."); see also *United States v. Mount Sinai Med. Ctr.*, 486 F.3d 1248, 1252 (11th Cir. 2007) ("The government's attempt to look past the plain language of the statute in reliance on the legislative history violates a basic principle of statutory interpretation."). The Eleventh Circuit in *Mount Sinai* reiterated the *Chevron* standard:

construction of a statute only when Congress has failed to address directly the question in dispute.⁹⁴ Given his resort to the regulations, Judge Kyle's finding that § 3121(b)(10) was "not ambiguous" was, therefore, either improper or an inadvertent misstatement of his actual belief. Were he truly to have read the statute as unambiguous, reliance on agency construction would have been unnecessary, and a determination of the exception's applicability to Mayo residents would have relied solely upon the application of § 3121(b)(10). But as noted, the great substance of *Mayo I* focuses on an analysis of the regulations.

This omission is problematic for taxpayers hoping to rely on *Mayo I* and its disposition. Federal courts determining that the student exception was inapplicable to medical residents as a matter of law⁹⁵ found, as a preliminary matter, the language of § 3121(b)(10) to be ambiguous.⁹⁶ Whether those analyses of § 3121(b)(10)'s ambiguity were without error is a separate question; engaging in this famous *Chevron* "first prong" analysis is a necessary first step to any regulatory review in cases where an agency's interpretation of a statute is in dispute.⁹⁷ That the *Detroit Medical Center* and *Albany Medical Center* courts conducted this analysis arguably strengthens the internal

"[W]hen the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Id.* (quoting *Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 U.S. 1, 6 (2000)).

94. See *Chevron*, 467 U.S. at 843 ("If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation."). The Court in *Chevron* went on to state: "Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." *Id.* (emphasis added).

95. See *Albany Med. Ctr. v. United States*, No. 1:04-CV-1399, 2007 WL 119415, at *2 (N.D.N.Y. Jan. 10, 2007) ("Although it is clear that residencies have an educational component, it is equally clear that patient care in a hospital setting is a prominent concern. Therefore, it is appropriate to review the history behind the legislation."); *United States v. Detroit Med. Ctr.*, No. 05-71722, 2006 WL 3497312, at *10–11, *14 (E.D. Mich. Dec. 1, 2006) (finding the relevant treasury regulations ambiguous on the issue in dispute and that the exception's legislative history required that medical residents be covered by FICA).

96. See *Albany Med. Ctr.*, 2007 WL 119415, at *5 ("[W]hether a medical resident qualifies as 'a student who is enrolled and regularly attending classes at such school, college, or university' is not a question that is resolvable by resorting to the text of IRC § 3121 alone."); *Detroit Med. Ctr.*, 2006 WL 3497312, at *8 ("The statute is unclear in a variety of ways: whether a medical resident may be considered a student; whether a GME program may be classified as a[n] SCU; and finally, whether the services provided by medical residents may be considered services performed in the employ of the [SCU].").

97. See *Chevron*, 467 U.S. at 842–43 ("If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.").

reasoning of those decisions and lends greater credibility to their legal conclusions. *Mayo I* lacks such reasoned analysis on this particular issue. While helpful to an understanding of *Apfel*'s case-by-case approach, *Mayo I* should be criticized for its failure to ask the truly important question: On the precise issue of whether GME residents qualify for the student exception, is Congress's intent clear?

Looking beyond this error, *Mayo I* stands for the proposition that, while the language of § 3121(b)(10) may be ambiguous, the Treasury's interpretative regulations are clear and capable of answering unambiguously the question of whether the student exception applies to medical residents. In other words, *Mayo I* perpetuated *Apfel*'s case-by-case approach, while keeping the analysis within the limits of regulatory language. Under this approach, statutory and legislative histories are irrelevant.

B. The Minority Approach: Detroit Medical Center

In 2006, the District Court for the Eastern District of Michigan took a different stance than the *Apfel* and *Mayo I* courts, relying on what it believed to be a clear congressional intent to include all medical residents under FICA.⁹⁸ In *United States v. Detroit Medical Center*,⁹⁹ the Government brought suit against the Detroit Medical Center (DMC) for repayment of Social Security tax refunds which DMC had requested successfully in 2003.¹⁰⁰ In responding to the Government's repayment action, DMC offered two grounds for claiming entitlement to the refund, one of which was its assertion that the student exemption should be held applicable to DMC's medical residents (the precise argument advanced by the taxpayer in *Mayo I*).¹⁰¹

98. See *Detroit Med. Ctr.*, 2006 WL 3497312, at *12 ("To exempt medical residents conflicts with Congress' intent to have young doctors covered by Social Security as shown by the statutory history.").

99. See *id.* at *14 (granting summary judgment in favor of the United States and finding student exception from FICA taxation inapplicable to stipends paid by defendant to their medical residents).

100. *Id.* at *1. DMC had based its original refund petition on the theory that its medical residents qualified for the student exemption under § 3121(b)(10). *Id.*

101. See *id.* (noting DMC's introduction of the argument that the stipends constituted "noncompensatory scholarships"). The District Court for the Eastern District of Michigan rejected DMC's scholarship theory, noting that even if DMC's program was "educational in nature, . . . the residents' stipends [were] given as a substantial *quid pro quo* for patient care." *Id.* at *4. DMC also brought a counterclaim against the United States for denials of FICA refunds for taxable years 1995, 1996, 1997, 2002, and 2003. *Id.* at *1.

To begin with, the court noted two important legal principles that would guide its analysis:¹⁰² first, that "the terms 'employment' and 'wages' are to be broadly construed since the very words, 'any service . . . performed . . . for his employer,' with the purpose of the Social Security Act in mind, import a breadth of coverage";¹⁰³ and second—related to this concept of broad statutory construction—that "the taxpayer bears the burden of establishing a tax exemption."¹⁰⁴ With these in mind, the court looked to the jurisprudential landscape of student exemptions in the Tax Code: "Since the ruling in *Apfel*, there have been two distinct approaches that the district courts have

102. *See id.* at *5 (noting the importance of "consider[ing] general principles of coverage under Social Security as directed by the Supreme Court").

103. *Id.* (internal quotations omitted) (quoting *Soc. Sec. Bd. v. Nierotko*, 327 U.S. 358, 365 (1946)); *see also* *United States v. Silk*, 331 U.S. 704, 711–12 (1947) ("The very specificity of the exemptions, however, and the generality of the employment definitions indicates that the terms 'employment' and 'employee,' are to be construed to accomplish the purpose of the legislation . . . [and] a constricted interpretation . . . would not comport with [the court's] purpose."). *But see* 42 U.S.C. § 410(j)(2) (2000) (noting that the term "employee" should be understood as "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee") (emphasis added); *Grantham v. Beatrice Co.*, 776 F. Supp. 391, 396 n.5 (N.D. Ill. 1991) ("[E]ven if Congress at one point intended . . . the [Social Security Administration] . . . to have a broader sweep than the common law definition of 'employee' would allow, Congress no longer has such an intention.").

104. *United States v. Detroit Med. Ctr.*, No. 05-71722, 2006 WL 3497312, at *6 (E.D. Mich. Dec. 1, 2006) ("[E]xemptions from taxation are not to be implied; they must be unambiguously proved." (quoting *United States v. Wells Fargo Bank*, 485 U.S. 351, 354 (1988))). This narrow view of tax exemptions emanates almost exclusively from cases dealing with provisions found within the revenue and estate tax chapters of the Internal Revenue Code. For example, the issue in *Wells Fargo* was whether an exemption from state and federal estate tax liability could be implied from federal statutes outside the Internal Revenue Code and evidence of congressional intent. *Wells Fargo*, 485 U.S. at 355. The Court, employing a canon of strict construction traditionally associated with tax exemptions, refused to imply the exemption. *Id.* at 359; *cf.* *U.S. Trust Co. of N.Y. v. Helvering*, 307 U.S. 57, 60 (1939) ("Exemptions from taxation do not rest upon implication."). Because the objectives of the FICA and revenue tax schemes are different, *see supra* note 73, an argument could be made that the standards by which courts review exemptions found within those tax schemes should reflect those differences. *But see* *United States v. Mount Sinai Med. Ctr.*, 353 F. Supp. 2d 1217, 1222 (S.D. Fla. 2005) ("Courts are to err on the side of including employees in the system unless an exemption is *beyond question*." (emphasis added)); *United States v. Silk*, 331 U.S. 704, 712 (1947) ("As the federal social security legislation is an attack on recognized evils in our national economy, a constricted interpretation of the phrasing by the courts would not comport with its purpose."). The *Silk* Court further noted: "Such an interpretation would only make for a continuance, to a considerable degree, of the difficulties for which the remedy was devised and would invite adroit schemes by some employers and employees to avoid the immediate burdens at the expense of the benefits sought by the legislation." *Id.* at 711–12.

employed when handling [similar] cases."¹⁰⁵ The court began its survey of this case law with a review of the Eighth Circuit's analysis in *Apfel*.¹⁰⁶

The *Detroit Medical Center* court recognized that the *Apfel* approach had become the analytical instrument employed by a majority of the district courts which had considered the student exemption issue.¹⁰⁷ These district courts "determined based merely on either the [exemption] statute's language or [its] language as interpreted by the Treasury Regulations, [that] GME programs may establish through a *facts and circumstances inquiry* that their residents qualify for the student exemption," as seen in the *Apfel* case-by-case approach.¹⁰⁸

The minority approach, as employed here,¹⁰⁹ generally looks beyond the plain language of the exemption statute and its interpretive regulations to find the student exemption inapplicable to medical residents as a matter of law.¹¹⁰ In arriving at this conclusion (and notably without substantial supportive reasoning), the *Detroit Medical Center* court determined that the treasury regulation was ambiguous as to whether a GME program properly fell within

105. *Detroit Med. Ctr.*, 2006 WL 3497312, at *8.

106. *Id.* at *6–7. For an overview of the *Apfel* decision, see *supra* Part II.A.

107. See *Detroit Med. Ctr.*, 2006 WL 3497312, at *8 ("A majority of district courts, relying on *Apfel*, have determined that . . . GME programs may establish through a facts and circumstances inquiry that their residents qualify for the student exemption."). In support of this assertion, the court cited four cases which utilized the majority approach: *Univ. of Chi. Hosps. v. United States*, No. 05 C 5120, 2006 U.S. Dist. LEXIS 68695 (N.D. Ill. Sept. 8, 2006); *Ctr. for Family Med. v. United States*, 456 F. Supp. 2d 1115 (D.S.D. 2006); *United States v. Univ. Hosp., Inc.*, No. 1:05CV445, 2006 WL 1173455 (S.D. Ohio Mar. 29, 2006); and *United States v. Mayo Found. for Med. Educ. & Research*, 282 F. Supp. 2d 997 (D. Minn. 2003). *Id.* at *8 & n.1.

108. *Detroit Med. Ctr.*, 2006 WL 3497312, at *8 (emphasis added).

109. *Id.* The court determined that the regulations interpreting the student exemption were ambiguous on the issue of whether GME programs should "fall under the commonly or generally accepted meaning of the term 'school, college or university,'" and distinguished the programs as educational only to the extent they were comparable to apprenticeships. *Id.* at *10. The court also found the regulations ambiguous as to whether medical residents were in fact "students" under the exemption. *Id.* at *11. Finding little difference between the language of the statute and its interpretive regulation, the court stated: "[I]t is unclear whether a medical residents' [sic] . . . work involved at the hospitals may be considered 'incident to' or 'for the purposes of study.' It is more likely that a medical resident's study is incident to and for the purposes of work." *Id.* The court focused its analysis on the statutory history and legislative intent of the student exemption in the context of the Social Security Act. *Id.* at *11–14.

110. This approach was first established in *United States v. Mount Sinai Medical Center*. See *United States v. Mount Sinai Med. Ctr.*, 353 F. Supp. 2d 1217, 1230 (S.D. Fla. 2005) (finding "as a matter of law, medical residents are not students who are exempt from FICA taxation"). Looking to a legislative history from 1939, the court was persuaded that "Congress made clear that the intern exception did not apply to residents." *Id.* at 1223.

the meaning of an SCU.¹¹¹ Further, the court found the regulation ambiguous as to whether residents were "students" under § 3121(b)(10),¹¹² arguing that the language of the regulation lacked any guidance as it was too similar to the language of its related statute.¹¹³ Therefore, resort to the history of the student exception and discussion of the developments of the Social Security Act from the time of its enactment in 1935 were, in the court's view, proper.¹¹⁴

The court first turned to Congress's 1965 repeal of the student intern exception, which Congress enacted concurrent with the student exception in 1939.¹¹⁵ Such action, the court believed, was evidence that Congress intended to protect, through FICA coverage, all "actual and future doctors once their

111. See *Detroit Med. Ctr.*, 2006 WL 3497312, at *10 ("Although GME programs provide a type of education to their residents, they are educational in a way similar to an apprenticeship or a position that involves on the job training."). Note how differently this court views "on-the-job training" in the context of GME programs from the court in *Mayo I.* See *supra* notes 55–57 and accompanying text (discussing residents' motivation for participating in Mayo's GME program). Moreover, the *Detroit Medical Center* court seems not to be persuaded by the "interconnectivity" aspect of residency education. See *supra* note 76 and accompanying text (discussing Mayo's emphasis on the importance of kinesthetic learning).

112. See *Detroit Med. Ctr.*, 2006 WL 3497312, at *11 (E.D. Mich. Dec. 1, 2006) (finding it "unclear whether a medical residents' [sic] extensive amount of work involved at the hospitals may be considered 'incident to' or 'for the purposes of study.' *It is more likely that a medical resident's study is incident to and for the purposes of work.*" (emphasis added)).

113. See, e.g., *Gonzales v. Oregon*, 546 U.S. 243, 260–64 (2006) (distinguishing *Chevron* and *Skidmore* in refusing to show deference to interpretive rules when an agency, after promulgating legislative rules containing language identical to its controlling statute, then subsequently relied upon such interpretive rules—which were not subject to a formal rulemaking process—for implementation of the statute).

114. *Detroit Med. Ctr.*, 2006 WL 3497312, at *11–13. The court rejected DMC's argument that use of extrinsic evidence was improper under *Exxon Mobil Corporation v. Allapattah Services*. See *id.* ("Extrinsic materials have a role in statutory interpretation only to the extent they shed a reliable light on the enacting Legislature's understanding of otherwise ambiguous terms." (quoting *Exxon Mobil Corp. v. Allapattah Servs.*, 545 U.S. 546 (2005))). The *Detroit Medical Center* court notes that every other federal court deciding this issue (with one exception) has looked beyond § 3121(b)(10) itself, implying that all courts have found the statute ambiguous on its face. *Id.* at *9. The court's reasoning, however, is not readily apparent. It would seem that any application of the student exception would require an understanding of the program seeking to invoke the same. While the *Detroit Medical Center* court would like to reject the case-by-case approach of *Apfel*, it seems to be engaging in just that here. "[I]t is generally accepted that GME programs are not generally considered 'schools, colleges, or universities,' *no matter what* organization places its name on the program." *Id.* at *10 (emphasis added).

115. *Detroit Med. Ctr.*, 2006 WL 3497312, at *12 (noting that in 1939, Congress recognized a difference between students and medical interns as well as between resident doctors and medical interns). "The legislative history of the 1939 Amendment in the form of a House Report explained the intern exception covered only an intern, 'as distinguished from a resident doctor.'" *Id.* (quoting H.R. REP. No. 76-728, at 550–51 (1939)).

undergraduate schooling [was] complete."¹¹⁶ This argument, however, appears misguided. It is generally accepted that the concept of "intern" is no longer part of the medical education construct.¹¹⁷ While interns and resident doctors might once have been separate and distinct labels for "young doctors," that distinction no longer exists.¹¹⁸ And the *Detroit Medical Center* court's statement—"[a]t no time did medical residents qualify for the student exception or any other exception"—seems conclusory. While *Apfel* appears to be the first case in which the student exception made its appearance in conjunction with GME programs and medical residents, this in no way suggests the general student exception was previously unavailable to medical residents. American graduate medical education has seen significant change over the past sixty years, and the *Detroit Medical Center* court's reliance on anachronistic distinctions arguably

116. *Id.*

117. See *infra* notes 180–81 and accompanying text (describing three types of generally recognized residency programs, including a transitional year program designed for residents who have not decided on a specialty of medicine). The transitional year program seems to be the only remnant of what Congress referred to as an "intern" in 1939.

118. See *United States v. Detroit Med. Ctr.*, No. 05-71722, 2006 WL 3497312, at *13 (E.D. Mich. Dec. 1, 2006) ("[T]he statutory construction, the statutory history and the legislative history make clear that students, interns, residents-in-training, and physicians fit under separate categories that are not meant to overlap."). The courts posited that, because Congress created "independent" exemptions for students, interns and residents, qualification for one exemption necessarily barred that taxpayer from qualifying under another—the exemptions were in effect mutually exclusive. *Id.* Relying on a 1939 House Report, the court also drew a distinction between medical residents and medical interns. *Id.* "Allowing medical residents to now fall under the student exception . . . , even though medical interns would not be permitted to fall under the student exception *due to the principles of statutory construction* would thwart congressional intent." *Id.* (emphasis added). *But see United States v. Mount Sinai Med. Ctr.*, 353 F. Supp. 2d 1217, 1228 (S.D. Fla. 2005) (noting taxpayer's argument that Congress repealed the intern exception in 1965 because "the service-oriented intern of 1939 no longer existed"). The Mount Sinai court defined an intern as "a resident in his or her first year of training out of medical school." *Id.* at 1219. In light of the court's overall analysis, this statement is problematic. Not only does this definition contain terms which the court itself endeavored to define (namely "resident"), but its reasoning is completely circular: If a medical resident "is a person who has received [a terminal] degree and is undergoing further training in a medical . . . specialty," *id.*, then an "intern"—i.e., "a resident in his or her first year of training"—will always constitute a "medical resident." If one accepts the notion that "exclusions from coverage that were adopted in 1939 were very narrowly drafted," *id.* at 1224, and that students, interns, and residents were intended to "fit under separate categories . . . not meant to overlap," *Detroit Med. Ctr.*, 2006 WL 3497312, at *13, an intern would never qualify for FICA exemption under the intern exception provision. The court asserts that "[i]nterpreting the *student exception* to include *medical residents* would violate the rule that no statute should be read in such a way as to make any of its provisions superfluous." *Mount Sinai*, 353 F. Supp. 2d at 1229 (emphasis added). But an adoption of the court's reading of the statute would, in fact, make the intern exception provision superfluous, which was the court's very concern with finding the student exception applicable to residents. *Id.* at 1228.

was improper. Nevertheless, the court stated that, while applicability of the student exception, in the wake of the repeal of the intern exception, indeed may have some merit, it was for Congress—and not the judiciary—to make such a clarification.¹¹⁹ Accordingly, the court found that, as a matter of law, the student exception under § 3121(b)(10) was inapplicable to DMC and its medical residents.¹²⁰

III. The Tax Scheme

A. Social Security Act of 1935 and the Federal Insurance Contributions Act

The framers of Social Security contemplated several models of providing social insurance, specifically as to whether the program should be funded, in part, by contributions made by the federal government (wholly separate from the collection of the withheld payroll taxes), or whether the program should be entirely self-supporting.¹²¹ Drafters considered the idea that employers with private pension plans could opt-out of social insurance coverage.¹²² Congress ultimately settled on an old-age insurance program which would be entirely self-supporting,¹²³ funded by both employee and employer contributions,¹²⁴ and which omitted any voluntary abstention provisions.¹²⁵

In 1939, the tax withholding provisions of the Social Security Act of 1935 were repealed, only to be re-enacted the same year as the Federal Insurance Contributions Act (FICA).¹²⁶ The current Social Security system operates under FICA, with important modifications.¹²⁷ The 1939 amendments had significant effects on the functioning of the program and its overall goals: "[T]he program moved away from the individualistic equity goals in the 1935 Act toward the goal of providing adequate benefits. Over the years, debate has continued over the relative weight that the equity and adequacy goals of the program should

119. *Detroit Med. Ctr.*, 2006 WL 3497312, at *13.

120. *Id.* at *14.

121. SYLVESTER J. SCHIEBER & JOHN B. SHOVEN, *THE REAL DEAL: THE HISTORY AND FUTURE OF SOCIAL SECURITY* 38 (1999).

122. *Id.*

123. *Id.* at 40–41.

124. *Id.* at 33.

125. *Id.* at 38.

126. *Id.* at 64.

127. *See* H.R. REP. NO. 728, 76th Cong., 1st Sess. 18, 1939-2 C.B. 538 (1939) ("The present bill is designed to widen the scope and to improve the adequacy and the administration of these [social welfare] programs without altering their essential features.").

receive."¹²⁸ One significant modification to the Act was the adoption of the student exception.

B. History of the Student Exception

The student exception provision of § 3121(b)(10) existed in a different form when Congress first enacted it in 1939 under FICA.¹²⁹ The 1939 version of the exception read:

The term "employment" means any service of whatever nature, performed within the United States by an employee for his employer, except . . . (8) [s]ervice performed in any calendar quarter in the employ of any organization exempt from income tax under section 101 of the Internal Revenue Code, if . . . (iii) such service is performed by a student who is enrolled and is regularly attending classes at a school, college, or university.¹³⁰

Contemporaneous legislative intent regarding the 1939 student exemption is sparse, but one comment is particularly pertinent to the issue discussed in this Note:

In order to eliminate the nuisance of inconsequential tax payments the bill excludes certain services performed for fraternal benefit societies and other non-profit institutions exempt from income tax, and certain other groups. While the earnings of a substantial number of persons are excluded from this recommendation, the total amount of earnings involved is undoubtedly very small. . . . *The intent of the amendment is to exclude those persons and those organizations in which the employment is part-time or intermittent and the total amount of earnings is only nominal, and the payment of the tax is inconsequential and a nuisance. The benefit rights built up are also inconsequential.* Many of those affected, such as students . . . will have other employment which will enable them to develop insurance benefits. This amendment, therefore, should simplify the administration for the worker, the employer, and the Government.¹³¹

The government's motivation for including this exception appears to have been a fear that the costs to society associated with the collection of taxes from employees (and their employers) receiving minimal compensation would

128. SCHIEBER & SHOVEN, *supra* note 121, at 59.

129. See Federal Insurance Contributions Act of 1939, 26 U.S.C. §§ 1400–1431 (imposing additional tax on both employees and their employers).

130. *Id.* § 1426(b).

131. H.R. REP. NO. 728, 76th Cong., 1st Sess. 18, 1939-2 C.B. 538, 543 (1939) (emphasis added).

exceed any FICA revenue from such collection, thus creating inefficiency in the overall program. The importance of establishing an economical social welfare system was recognized from the beginning of the Act, along with a need constantly to reassess the program in order to discover possible areas of weakness and opportunities for improvement.¹³²

The Internal Revenue Code of 1939 also delegated rulemaking authority to the Secretary of the Treasury for purposes of administering the tax collection process.¹³³ In 1940, the Secretary promulgated regulations under FICA,¹³⁴ which stated in pertinent part:

Services performed . . . by a student in the employ of a school, college, or university not exempt from income tax under section 101 of the Internal Revenue Code are excepted, provided: (a) The services are performed by a student who is enrolled and is regularly attending classes at such school, college, or university; and (b) The remuneration for such services performed . . . does not exceed \$45.¹³⁵

132. *See id.* ("Tremendous as is the scope of [the Social Security] program, it was recognized from the beginning that changes would have to be made as experience and study indicated lines of revision and improvement.").

133. *See* 26 U.S.C. § 1429 (1939) ("Secretary shall make and publish such rules and regulations . . . as may be necessary to the efficient administration of the functions with which he is charged under this subchapter. The Commissioner, with the approval of the Secretary, shall make and publish rules and regulations for the enforcement of this subchapter."). Under current law, the Secretary of the Treasury can issue two types of regulations: legislative regulations pursuant to specific congressional delegation; or interpretive regulations pursuant to the Secretary's general rulemaking authority under 26 U.S.C. § 7805(a). *See* 26 U.S.C. § 7805(a) (2000) ("[T]he Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.").

134. The 1940 regulations were promulgated under title II of the Social Security Act and amendments effective prior to January 1, 1940. *See* 20 C.F.R. § 403.1(a), Introductory (1940). Note also that the regulations relating to benefits provided for under title II of the Social Security Act were originally promulgated under § 402 of title 20 of the Code of Federal Regulations. *See id.* § 403.1(b), Introductory (1940).

135. 20 C.F.R. § 403.821 (1940). The regulations further explained:

[T]he type of services performed by the employee and the place where the services are performed are immaterial; the statutory tests are the character of the organization in whose employ the services are performed, the amount of remuneration for services performed by the employee in the calendar quarter, and the status of the employee as a student enrolled and regularly attending classes at the school, college, or university in whose employ he performs the services. The term "school, college, or university" within the meaning of this exception is to be taken in its *commonly or generally accepted sense*.

Id. (emphasis added).

This regulation reflects the stated legislative intent of the 1939 amendments inasmuch as it prescribes a nominal amount requirement for the exception to apply.¹³⁶ However, the nominal amount requirement was abandoned by Congress in 1950 when the various student exclusions of the 1939 amendments were consolidated into one student exception provision.¹³⁷ The Government has argued that Congress's intent, as first espoused in 1939, to limit the student exclusion to those whose "total amount of earnings is only nominal" should control any current reading of the statute.¹³⁸ Federal courts, however, consistently have rejected this position, noting that the applicable treasury regulations unambiguously omit a nominal amount requirement.¹³⁹

On January 16, 1998, the IRS released Revenue Procedure 98-16, which established standards for determining whether services performed by students in the employ of institutions of higher education would qualify for the student

136. *But see* Social Security Act Amendments of 1939, Pub. L. No. 76-379, § 606, 53 Stat. 1360, 1385 (1939) ("Service performed . . . in the employ of an organization exempt from income tax under section 101, if the remuneration for such service does not exceed \$45, or . . . such service is performed by a student who is enrolled and is regularly attending classes at a school, college, or university." (emphasis added)). Note the absence of a nominal amount requirement in the latter part of this regulation.

137. *See* *Univ. of Chi. Hosps. v. United States*, No. 05 C 5120, 2006 WL 2631974, at *4 (N.D. Ill. Sept. 8, 2006) ("Moreover, in 1950, when Congress consolidated the student exclusions, it opted not to include any limitation on remuneration [sic] but maintained it for the exclusion for wages earned at a nonprofit organization." (citing Social Security Act Amendments of 1950, Pub. L. No. 81-734, § 204(a), 64 Stat. 477, 531 (1950))).

138. *See id.* at *3 (noting Government's reliance on the 1939 House Report discussing the amendments to the Social Security Act of 1935); *United States v. Detroit Med. Ctr.*, No. 05-71722, 2006 WL 3497312, at *10 (E.D. Mich. Dec. 1, 2006) (discussing Government's argument that prior court rulings finding nominal amount requirement for a similar "student nurse" exception demanded similar treatment of the general student exception).

139. *See Univ. of Chi. Hosps.*, 2006 WL 2631974, at *3 ("In this case, the Treasury Regulation at issue . . . clearly states that the amount of remuneration [sic] earned by an individual is immaterial to the applicability of the student exclusion."). The court further noted that, "[b]ecause the plain language of the Treasury Regulation is clear, there is no need to resort to other sources, such as the agency's interpretation of its regulation or the legislative history of the underlying statute, to determine its meaning." *Id.* (citations omitted). *See also Det. Med. Ctr.*, 2006 WL 3497312, at *10 (agreeing with the district court in *University of Chicago Hospitals* that the regulation "unambiguously does not include a nominal compensation requirement"). In *Detroit Medical Center*, the Government urged the court to review the student exception in the context of the Sixth Circuit's treatment of the student "nurse exception," which was enacted concurrently with the general student exception in 1939. *Id.* In *Johnson City Medical Center v. United States*, the Sixth Circuit faced the question of what, if any, deference should be given to an IRS agency ruling. *Johnson City Med. Ctr. v. United States*, 999 F.2d 973, 975-78 (6th Cir. 1993). A majority of the court held that the IRS ruling was entitled to *Chevron* deference and that the nominal amount requirement was a valid exercise of the IRS's agency power. *Id.* at 977-98.

exception.¹⁴⁰ The Revenue Procedure categorically rejected the application of § 3121(b)(10) to medical residents, finding the services of such "students" incapable of being "incidental to and for the purpose of pursuing a course of study."¹⁴¹

This IRS policy was challenged later that year in *Apfel* when the State of Minnesota brought an action against the Commissioner of Social Security for redetermination of the state's liability for FICA tax contributions.¹⁴² As noted above, the Eighth Circuit, affirming the lower court, held in favor of the taxpayer, finding in part that medical residents at the University of Minnesota were employed by the University, their services were compensated in the form of stipends, and that the residents were "students" under the Section 218 agreement, thus overruling much of the substance of Revenue Procedure 98-16.¹⁴³ The effect of this ruling was a polarization of the issue—the IRS had been beaten twice on the student exception question, which forced them to review the language of the relevant regulations, and institutions similar to the Mayo Foundation were given great incentive to seek FICA refunds.

C. Amendments to Regulations After Mayo I

On February 25, 2004, the IRS responded to *Mayo I* by publishing its Notice of Proposed Rulemaking to amend the regulations defining "student" and "school, college, or university."¹⁴⁴ The IRS was concerned that residency programs were akin to "on-the-job training" and were not properly included under the FICA student exception.¹⁴⁵ Furthermore, the IRS sought to resurrect the "primary purpose" test rejected by the court in *Mayo I*.¹⁴⁶ Prior to the 2004 amendments, the regulations stated: "The term

140. Rev. Proc. 98-16, 1998-1 C.B. 403 (Feb. 2, 1998).

141. *Id.* at 2.02.

142. See *Minnesota v. Apfel*, 151 F.3d 742, 748 (8th Cir. 1998) (affirming district court's ruling in favor of Minnesota). For an overview of the *Apfel* decision, see *supra* Part II.A.

143. *Apfel*, 151 F.3d at 747–48.

144. See Student FICA Exception, 69 Fed. Reg. 8604 (proposed Feb. 25, 2004).

145. See *Mayo Found. for Med. Educ. & Research v. United States (Mayo II)*, 503 F. Supp. 2d 1164, 1168 (D. Minn. 2007) (discussing the IRS's motivation for readdressing those issues which had been "resolved" by both the Eighth Circuit in *Apfel* and the district court in *Mayo I*).

146. See 69 Fed. Reg. 8604, 8605–06 (declaring that the primary purpose standard, notwithstanding its rejection by *Mayo I*, "is consistent with the language of section 3121(b)(10) and the existing regulations thereunder, and is consistent with the intended scope of the student FICA exception"); see also *infra* notes 151–62 and accompanying text (discussing factors which Judge Kyle considered in finding medical residents properly excluded from FICA tax liability and specifically rejecting the "primary purpose" test).

'school, college, or university' within the meaning of [the student exception] is to be taken in its commonly or generally accepted sense."¹⁴⁷ Final regulations were published on December 21, 2004 (effective April 1, 2005), amending the regulations relating to § 3121(b)(10).¹⁴⁸ These final amended regulations stated:

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.¹⁴⁹

This primary function test was again rejected by Judge Kyle in *Mayo Foundation for Medical Education and Research v. United States (Mayo II)*.¹⁵⁰ Readopting the familiar case-by-case analysis, Judge Kyle noted that "[w]hether an organization qualifies as a 'school, college, or university' is a factual inquiry."¹⁵¹ The amended regulations also included a full-time employee exception declaring that "an employee whose normal work schedule is 40 hours or more per week is considered a full-time employee."¹⁵² Services performed by that taxpayer, therefore, were "not incident to and for the purpose of pursuing a course of study."¹⁵³ Further, "the fact that the services performed by the employee may have an educational, instructional, or training aspect" will not affect the "normal work schedule."¹⁵⁴ As the *Mayo II* court noted, the student exception would be inapplicable to medical residents working over forty hours per week.¹⁵⁵

Judicial review of interpretive tax regulations are governed by the Supreme Court's decision in *National Muffler Dealers Association, Inc. v. United States*.¹⁵⁶ "In determining whether a particular regulation carries out the

147. 26 C.F.R. § 31.3121(b)(10)-2(d) (2003).

148. Rules & Regulations, Student FICA Exemption, 69 Fed. Reg. 76404-01 (Dec. 21, 2004).

149. 26 C.F.R. § 31.3121(b)(10)-2(c) (2008) (emphasis added).

150. See *Mayo II*, 503 F. Supp. 2d at 1174 (invalidating the primary function test as inconsistent with a plain reading of the student exception statute).

151. *Id.* at 1173; see also *United States v. Mayo Found. for Med. Educ. & Research (Mayo I)*, 282 F. Supp. 2d 997, 1006-07 (D. Minn. 2003) (noting Government's failure to persuade the court that a case-by-case analysis was improper).

152. 26 C.F.R. § 31.3121(b)(10)-2(d)(3)(iii).

153. *Id.*

154. *Id.*

155. *Mayo Found. for Med. Educ. & Research v. United States (Mayo II)*, 503 F. Supp. 2d 1164, 1169 (D. Minn. 2003).

156. See *Nat'l Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 484 (1979) (finding

congressional mandate in a proper manner, [the courts] look to see whether the regulation harmonizes with the plain language of the statute, its origin, and its purpose."¹⁵⁷ Unsurprisingly, consistent with his decision in *Mayo I*, Judge Kyle held that the language of § 3121(b)(10) was uncomplicated and "straightforward."¹⁵⁸ Noting that neither Congress nor the IRS had ever indicated that a "primary function" test should apply in determining an employer's status as an SCU,¹⁵⁹ the court invalidated those amendments relating to that test.¹⁶⁰ Under a similar rationale, Judge Kyle also invalidated the "full-time employee" exception, stating that it was "inconsistent with the plain meaning of the statute and [was] arbitrary, capricious, and unreasonable."¹⁶¹ The practical effect of the *Mayo II* ruling, therefore, was to return the regulations to the form in which they existed prior to April 1, 2005 (the effective date of the amendments), safe—if only temporarily—from IRS modification.

D. What Now?

The history of the student exception's development makes it quite clear that the IRS is as dead-set on requiring medical residents to contribute to Social Security as the medical community is in seeking to qualify for the exemption. From relying on outdated legislative history to amending its regulations in a manner directly adverse to medical residents and their GME sponsors,¹⁶² the IRS's position might fairly be characterized as punitive. Furthermore, the

that the Commissioner of Internal Revenue's reading of an exemption statute was a reasonable, although not exclusive, construction of Congress's intent, and accordingly was entitled to "serious deference").

157. *Id.* at 477.

158. *Mayo II*, 503 F. Supp. 2d at 1172 (citing *United States v. Mayo Found. for Med. Educ. & Research (Mayo I)*, 282 F. Supp. 2d 997, 1007, 1013 (D. Minn. 2003)); *see also* *United States v. Mount Sinai Med. Ctr.*, 486 F.3d 1248, 1251 (11th Cir. 2007) (finding error with district court's review of "legislative history without first determining whether the language of the statute was ambiguous").

159. *Mayo II*, 503 F. Supp. 2d at 1174 n.7.

160. *Id.* at 1174.

161. *See id.* at 1174–75 ("The full-time employee exception arbitrarily narrows this definition by providing that a 'full-time' employee is not a 'student' even if the educational aspect of an employee's service predominates over the service aspect."). "A natural reading of the full text in which the term 'student' appears demonstrates that an employee is a 'student' so long as the educational aspect of his service predominates over the service aspect of the relationship with his employer." *Id.* at 1175.

162. *See supra* notes 145–50 and accompanying text (reviewing language of the 2004 amendments to 26 C.F.R. § 31.3121(b)(10)-2(d)).

federal courts have been less than helpful in arbitrating the central disagreement of whether § 3121(b)(10) is ambiguous.¹⁶³ Given the divergence between the courts' respective rationales, resolution of this issue is unlikely to come from judicial action. Certain truths are inescapable: the language of the student exception is undeniably minimal; evidence of Congress's intent is lacking; and, so long as this issue remains unresolved, total litigation costs will continue to rise.¹⁶⁴

If one accepts the idea that § 3121(b)(10) (or at the very least, its interpretive regulations) is unambiguous, it could be argued that, despite FICA's widely acknowledged broad reach,¹⁶⁵ the fact that Congress penned the student exception with such plain language is a reflection of Congress's intent of wide application, thus requiring an understanding of the practical difficulties in constructing a law whose reach is far, but whose language is precise. Such is the dilemma with § 3121(b)(10). This Note focuses on the applicability of this exclusion with respect to medical residents, but the volume of individuals who potentially qualify for this exclusion is large. It would be overly cumbersome to require Congress to enumerate perfectly every set of circumstances that would (or would not) satisfy the requirements of the student exclusion. Such legal perfection is as unreasonable as it is impossible—no matter how comprehensive the exception provision could be written, there will always be a set of circumstances unanticipated by the legislature. So, absent confidence in the judiciary, the IRS, and taxpayers in the medical community to find a resolution, to whom should the law turn?

The majority approach requires a case-by-case analysis every time a taxpayer¹⁶⁶ seeks (or the United States challenges) a refund for FICA taxes under the student exemption.¹⁶⁷ While this Note has argued that such an approach is preferable to any alternatives currently employed by the federal courts, the unique characteristics of the GME programs suggest that, as a practical matter, these programs should be afforded the presumption of

163. Compare *supra* Part II.A (presenting the majority view of the courts that declares § 3121(b)(1)'s language unambiguous), with *supra* Part II.B (presenting the minority view of the courts that declares the language ambiguous).

164. This is especially true if a majority of the courts continue to employ the *Apfel* approach, since a case-by-case analysis requires a trial, whereas the minority approach can be—and often has been—subject to summary judgment.

165. See, e.g., *supra* notes 104–05 (presenting the view that FICA has a broad statutory coverage).

166. The use of "taxpayer" refers, of course, to either a medical resident or an organization sponsoring a GME program.

167. See *supra* notes 16–17 and accompanying text (introducing the majority case-by-case approach established in *Apfel*).

qualifying as a "school, college, or university," and residents the presumption of "student" status.

IV. Tax Policy

As can be gathered from the preceding discussion, tax law is indeed a complex amalgamation of several familiar jurisprudential sources. The common substantive elements of mostly all legal disciplines—statutory authority, administrative directive, and judicial interpretation and doctrine—are of undeniable importance to the tax field.¹⁶⁸ Beyond these, however, there exists an additional source of authority the appreciation of which is crucial to the resolution of any tax-related dispute: Policy. For example, it has been said that "[t]ax law is based on the moral notion that joint action implies joint payment for the instrumentalities of action."¹⁶⁹ In the context of Social Security, taxpayer protection against future economic hardship (such as decreased earning potential resulting from old-age, disability, or the loss of a spousal wage-earner) comes at the price of our mutual contribution to the Social Security system.¹⁷⁰ Due to these uncertainties of life, taxpayers are encouraged to contribute into the system as soon as they become eligible.¹⁷¹

The history of Social Security indicates that the drafters of current social welfare policies strived to implement a system with requirements that were as equitable as possible to taxpayers.¹⁷² However, very few individuals actually receive benefits commensurate with their share of contribution into that system:

168. See generally *supra* Part II (displaying the interrelation of all these elements in tax law).

169. Thomas C. Folsom, *Evaluating Supernatural Law: An Inquiry into the Health of Nations (The Restatement of the Obvious Part II)*, 21 REGENT U. L. REV. 105, 151 (2009).

170. See 1939-2 C.B. 538 (June 2, 1939) ("The enactment of the Social Security Act marked a new era, the Federal Government accepting, for the first time, responsibility for providing a systematic program of protection against economic and social hazards.").

171. See, e.g., Social Security: Coverage for Medical Residents, G.A.O. No. B-284947, at 9 (Aug. 31, 2000) [hereinafter GAO MEMO], available at <http://www.gao.gov> (noting Administration's belief "that treating residents as students could have other potential consequences for the medical residents, such as not earning credits toward retirement, survivor and disability benefits"); *United States v. Mount Sinai Med. Ctr. of Fla., Inc.*, 353 F. Supp. 2d 1217, 1228 (S.D. Fla. 2005) (noting the importance of Social Security coverage for young professionals because "in the early years of their practice, [they] may not otherwise have the means to provide adequate survivorship and disability protection for themselves and their families"); cf. GAO MEMO, *infra*, at 9 ("It is unlikely, however, that treating medical residents as students would have a significant effect on their retirement benefits.").

172. See *supra* note 128 and accompanying text (discussing considerations of equity and adequacy in establishing a social welfare system).

While Social Security aims to protect all participants, in practice, it does so at a disproportionate rate of return.¹⁷³ And while such disconnect between contribution and benefits eligibility might seem inequitable, it is not necessarily in contravention of the broader goals of Social Security.¹⁷⁴ Perhaps in response to this problem of cosmetic inequity, Congress included various exceptions and qualifications to the FICA regime in order to remedy the initial inequity of the new welfare system. These choices on how best to align contribution with the receipt of benefits were matters of policy. However, legislative history relating to specific examples of such exceptions and qualifications is quite limited, particularly with regard to the student exception under § 3121(b)(10).¹⁷⁵ A review of American GME programs supports the proposal that GME programs and their residents should be presumptively exempt from FICA tax liability.

V. American Graduate Medical Education Programs

An analysis of American GME programs—from both the perspective of the sponsoring institution and the residents themselves—suggests that medical residents presumptively qualify for the student exception under § 3121(b)(10). However, Congress, the IRS, and nearly every federal court dealing with this issue have failed to address this argument, perhaps because a detailed review of GME program requirements, established by the Accreditation Council for Graduate Medical Education (ACGME), rarely has played a role in attempted resolutions of the issue.

GMEs in the United States focus on the education and training of doctors who have graduated recently with an M.D. from a university (usually consisting of four years of study).¹⁷⁶ These GMEs offer new doctors opportunities to focus on a specific field of medical practice—general surgery, anesthesiology,

173. See Deborah A. Geier, *Integrating the Tax Burdens of the Federal Income and Payroll Taxes on Labor Income*, 22 VA. TAX REV. 1, 38 (2002) (noting both the cross-generational and intra-generational redistributive effects on the return on Social Security benefits from payment into that welfare system).

174. See *id.* at 27, 39 (noting that while it may be easier politically to pitch Social Security taxes as a payment into a mandatory, government-sponsored pension plan, in reality, taxes paid into Social Security are more accurately characterized as "supporting society-wide goals and benefits rather than merely individualized cash benefits").

175. See *supra* notes 130–33 and accompanying text (reviewing 1939 House Report on the amendments to the Social Security Act of 1935).

176. See ACGME—POLICIES AND PROCEDURES 63 (Feb. 9, 2009) [hereinafter POLICIES & PROCEDURES], available at <http://www.acgme.org> ("A residency program is a structured educational activity comprising a series of learning experiences in GME designed to conform to the program requirements of a particular specialty.").

or internal medicine, to name a few—and vary in length depending on the requirements of the sponsoring institution, the character of the chosen field, and standards established by the ACGME.¹⁷⁷ The ACGME recognizes three types of "residency programs" under the broad definition of the term.¹⁷⁸ These are: the traditional residency program, which serves as a continuation of the M.D. educational process; the subspecialty program, which narrows the resident's focus in his or her specialty; and the transition year program, which is designed to allow residents more of an opportunity to experience different specialties before committing to one specific program.¹⁷⁹

Administrators of GMEs must balance important and potentially conflicting interests in establishing the structure of their programs. These interests include clinical experience, instruction and self-study time, continuity of care, and the avoidance of resident fatigue.¹⁸⁰

A. *The Focus of GME Programs is Primarily Educational*

In 2001, the Occupational Safety and Health Administration (OSHA) heard a petition by the American Medical Association and others requesting, *inter alia*, the adoption of a limitation on maximum work hours for medical residents.¹⁸¹ ACGME's institutional standards currently contain many of that petition's proposals, specifically an eighty-hour limitation on residents' duty hours, one day off from all educational and clinical work for every seven days in rotation, and mandatory ten-hour break periods between call periods.¹⁸² The

177. "The Accreditation Council for Graduate Medical Education (ACGME) is a separately incorporated non-governmental organization responsible for the accreditation of Graduate Medical Education (GME) programs." *Id.* at 1. The ACGME has five member organizations or agencies: the American Board of Medical Specialties (ABMS), the American Hospital Association (AHA), the American Medical Association (AMA), the Association of American Medical Colleges (AAMC), and the Council of Medical Specialty Societies (CMSS). *Id.*

178. *Id.* at 63.

179. *Id.* at 63–64.

180. See Debra F. Weinstein, *Duty Hours for Resident Physicians—Tough Choices for Teaching Hospitals*, 347 NEW ENG. J. MED. 1275, 1275 (2002) (discussing problems associated with ACGME's limit on residents' work hours).

181. See *OSHA Rejects Medical Residents' Petition for 80-Hour Workweek*, BUS. & LEGAL REPORTS, Oct. 25, 2002, available at <http://safety.blr.com/news.aspx?id=89365> (noting OSHA's rejection of petitioners' request on ground that ACGME was better and more appropriately suited to address issue of excessive duty hours and limitations thereon). "In June 2002, the Accreditation Council for Graduate Medical Education (ACGME), which accredits nearly 8,000 residency programs in the United States, set new standards on resident work hours." *Id.*

182. See ACGME—COMMON PROGRAM REQUIREMENTS 13–14 (July 1, 2007) [hereinafter REQUIREMENTS], available at <http://www.acgme.org> (providing language on duty work hour

medical community frequently has voiced its concern over the safety of medical residents dealing with over-work and fatigue,¹⁸³ and the duty work hour limitations appear to have been adopted by ACGME with the aim of remedying this problem. However, the limitation creates a dilemma for GME administrators, as a reduction in hours risks a reduction in the amount of time residents spend on educational activities.¹⁸⁴

Arguably, one view of the role of medical residents in teaching hospitals is that they provide a form of "cheap labor" because their services may be substituted for those of faculty members whose compensation is commensurate with their level of experience and education.¹⁸⁵ Of course, the residents are supervised, and most decisions made by residents in the course of administering patient care are subject to the approval of a faculty physician.¹⁸⁶ This concept of resident cheap labor, however, was not a product of design; rather, that residents can be used by teaching hospitals to lower their overall costs associated with patient care merely reflects a natural allocation of the skills of hospitals' various caregivers.¹⁸⁷

Despite this phenomenon, the focus of American GME programs always has been a commitment to the educational and clinical development of young doctors. This is particularly apparent in the context of ACGME's position on duty work hours. "The program must be committed to and be responsible for promoting patient safety and resident well-being and to providing a supportive

limits substantially similar to the language contained in the petition to OSHA).

183. See *Asleep at the Bedside? IOM Says Feds Should Issue Tough Work Hour Limits*, HOSP. EMPLOYEE HEALTH, Feb. 1, 2009, available at 2009 WLNR 2453779 (noting one commentator's belief that "working for more than sixteen consecutive hours without sleep is hazardous for patients as well as the physicians themselves").

184. See Weinstein, *supra* note 180, at 1275 ("[A]s residents work fewer hours, their activities might be shifted further toward service at the expense of education . . . [which] would doom a program by alienating applicants and threatening accreditation.").

185. See Ferris M. Hall et al., *The Case for More U.S. Medical Students*, 343 NEW ENG. J. MED. 1573, 1574 (2000) (arguing that the surplus of medical resident positions over number of students graduating from U.S. medical schools is a reflection of "reliance of teaching hospitals . . . on residents as cheap labor to staff inpatient services").

186. See *United States v. Mount Sinai Med. Ctr. of Fla., Inc.*, 353 F. Supp. 2d 1217, 1220 (S.D. Fla. 2005) ("At no point during any part of the residents' education at Mt. Sinai was any resident permitted to, without the input and supervision of an attending physician: 1) perform surgery; 2) prescribe a treatment plan; or 3) make a clinical or physiological determination." (citations omitted)); *United States v. Mayo Found. for Med. Educ. & Research*, 282 F. Supp. 2d 997, 1003 (D. Minn. 2003) ("Much of the training in the [hospital's] residency programs involved clinical experiences, in which a resident learned by doing a medical task under the direct and personal guidance and supervision of a full-time Mayo staff physician." (citations omitted)).

187. See generally Hall et al., *supra* note 185.

educational environment. *The learning objectives of the program must not be compromised by excessive reliance on residents to fulfill service obligations.*"¹⁸⁸ While not rejecting explicitly the notion that residents play an important role in efficient and economical hospital administration, ACGME's commentary on the work hour limitation indicates that hospitals are not to exploit their residents for purposes of reducing administrative costs—commitment to education comes first. ACGME's accreditation processes, policies, and standards emphasize a focus on education over care-giving services for GME programs.¹⁸⁹

ACGME has reaffirmed the purpose of accreditation as "provid[ing] for training programs of *good educational quality* in each medical specialty."¹⁹⁰ ACGME requires that each institution seeking accreditation establish a curriculum for its GME programs with an emphasis on educational and scholarly purpose.¹⁹¹ The GME must employ a sufficient number of faculty so that the educational goals of the program's curriculum can be met adequately.¹⁹² Additionally, any institution wishing to alter its program's duty hour limitation must have an educational rationale.¹⁹³ If there is a "primary

188. ACGME—DUTY HOURS LANGUAGE 1 (2009), *available at* <http://www.acgme.org> (emphasis added).

189. *See generally* REQUIREMENTS, *supra* note 182 (establishing standards for all GME programs in the United States).

190. POLICIES & PROCEDURES, *supra* note 176, at 2 (emphasis added).

191. *Id.* at 7. Part IV of the Common Program Requirements states, in relevant part:

Educational Program—A. The curriculum must contain the following educational components: 1. Overall educational goals for the program, which the program must distribute to residents and faculty annually; 2. Competency-based goals and objectives for each assignment at each educational level, which the program must distribute to residents and faculty annually, in either written or electronic form. These should be reviewed by the resident at the start of each rotation. . . .

B. Residents' Scholarly Activities—The curriculum must advance residents' knowledge of the basic principles of research, including how research is conducted, evaluated, explained to patients, and applied to patient care. Residents should participate in scholarly activity. . . . The sponsoring institution and program should allocate adequate educational resources to facilitate resident involvement in scholarly activities.

REQUIREMENTS, *supra* note 182, at 7, 11.

192. *See id.* at 5 ("At each participating site, there must be a sufficient number of faculty with documented qualifications to instruct and supervise all residents at that location."). The program requirements go on to state: "The faculty must: devote sufficient time to the educational program to fulfill their supervisory and teaching responsibilities; and to demonstrate a strong interest in the education of residents, and administer and maintain an educational environment conducive to educating residents in each of the ACGME competency areas." *Id.*

193. *See* POLICIES & PROCEDURES, *supra* note 176, at 110 ("The request must be based on a sound educational rationale, which should be described in relation to the program's stated goals

purpose" underlying the relationship between a GME program and its residents, it seems clear that it is one based on education, as so much of ACGME's requirements outline standards of educational excellence and considerations based on the improvement of clinical learning.¹⁹⁴ Were the focus on the employment aspect of the GME's relationship with its residents, one could argue that ACGME approves a dual purpose for GME programs (education and labor). However, ACGME has been explicit on GMEs' responsibilities towards maintaining a standard of high quality education, even in the face of disrupting the status quo of teaching hospitals' work hours.¹⁹⁵

Of course, an argument could be made that the standards set forth by ACGME are overly idealistic and that many GME programs often force their residents—perhaps unofficially or even unwittingly—to exceed the eighty-hour limit established by ACGME, adversely affecting the educational motives of that GME program as well as its residents.¹⁹⁶ This argument is not without merit, but determining exactly how many programs are not in conformity with ACGME's accreditation standards (and the extent of their respective deficiencies) may prove far too difficult for any practical use. It might also be argued that GME programs do not necessarily share the goals and ideals of their regulating institutions, specifically the ACGME. It is natural that teaching hospitals might aspire to accomplish more than providing quality education to resident doctors.¹⁹⁷ Such hospitals have duties to their patients, to the communities in which they function, and arguably to the medical profession itself. But this says nothing of the relationship between the hospital and the residents, which, according to the federal courts, is the key focus of the student exception analysis.¹⁹⁸ In fact, and as this Note argues, access to patient care is an essential component of medical education, so even if the "primary function"

and objectives for the particular assignments, rotations, and level(s) of training for which the increase is requested.").

194. See *supra* notes 176–94 and accompanying text (reviewing the language of ACGME's various procedural requirements).

195. See *supra* note 193 and accompanying text (discussing ACGME's mandate of preserving educational focus in GME programs despite reduction in maximum duty work hours).

196. See, e.g., *United States v. Mount Sinai Med. Ctr. of Fla., Inc.*, 353 F. Supp. 2d 1217, 1220–21 (S.D. Fla. 2005) ("Residents during the time period at issue were not limited to working 80 hours per week, and some residents were spending more than 80 hours a week at the hospital performing patient care." (citations omitted)).

197. Alternatively, these hospitals may be associated with organizations or corporations which pursue a broader—perhaps corporate—interest.

198. See *supra* notes 150–55 and accompanying text (discussing Judge Kyle's rejection, in *Mayo II*, of the "primary function test" contained in the regulations as amended through 2005).

of a hospital sponsoring a GME program were something different than resident education, residents indisputably would benefit directly from the opportunities created by the hospital's patient care and community outreach programs.¹⁹⁹

Given ACGME's demonstrated standards of commitment to the education of medical residents (as opposed to their role as laborers in the medical market), American GME programs wishing to obtain or retain accreditation status are required to serve their residents primarily as educators.²⁰⁰ If a GME's relationship with its resident is educational, it follows that a resident's relationship with her GME program is also educational because ACGME's standards of education exist for the benefit of the residents' development as doctors.

VI. A Compromise

FICA's history is insufficient to establish Congress's intent to bar current-day medical residents from the student exclusion, and though the IRS and SSA are charged with promulgating regulations which implement the law of Social Security,²⁰¹ their efforts to include medical residents in FICA coverage de jure go against a great weight of relevant authority, both legal and policy-oriented alike.

Whether or not the statute and its implementing regulations are ambiguous has been a hotly contested issue over the past few decades.²⁰² And adequate resolution of the dispute by the federal court system seems unlikely. The courts which have reviewed the language of the student exception appear to have decided the preferable, equitable outcome of their respective cases a priori, and only then have they found some way to justify their conclusions. For example,

199. See *supra* notes 76–79 and accompanying text (arguing that the education of residents relies so heavily on kinesthetic learning techniques that patient care and graduate medical education cannot be separated—they are necessarily interconnected).

200. Judicial notice has been taken on the interconnectivity between "education" and "patient care." See, e.g., *United States v. Mayo Found. for Med. Educ. & Research (Mayo I)*, 282 F. Supp. 2d 997, 1014–15 (D. Minn. 2003) ("Because the objective of residency programs is ultimately to make physicians capable of caring for patients twenty-four hours a day and seven days a week, it is impossible to separate 'education' from 'patient care.'").

201. See GAOMEMO, *supra* note 171, at 2–3 ("Two federal agencies have key roles related to Social Security and FICA. SSA maintains individual records on each worker's reported wages subject to the FICA tax and distributes benefits based on these reported wages. IRS collects FICA taxes and issues refunds.").

202. See *supra* Part II (presenting the conflicting views over the existence of ambiguity in the language of § 3121(b)(1) and its implementing regulations).

in *Mayo I*, the court was too quick to find that the implementing regulations were unambiguous and moved right into a case-by-case analysis of the GME programs.²⁰³ Common sense, however, requires one to hesitate and question this approach, because the term "school, college, or university" is unquestionably broad. As this Note has argued, this term has no inherent meaning of its own—it requires boundaries and guidelines not found on the face of the statute.²⁰⁴ In fact, the term SCU most easily finds its meaning through an application of the facts of each case, and accordingly, any standardized interpretation of the term seems to be futile. Ultimately, the case-by-case approach first established in *Apfel* is appropriate, but the cost associated with re-litigating this issue in perpetuity outweighs the need for a facts-based standard of inquiry.

Even in *Detroit Medical Center*, the analysis is thin on substance. Most notably, the court summarily rejects the notion that a GME program could ever be a school, because, as it states, "it is generally accepted that GME programs are not generally considered 'schools, colleges, or universities,' no matter what organization places its name on the program."²⁰⁵ The source of this generalized conception of GME programs is unclear, but certainly, a "generalized conception," if it is to have any teeth as a judicial conclusion, should be based on accurate facts and circumstances. The *Detroit Medical Center* court attempted to bypass the *Apfel* case-by-case approach so that it might rely upon particular legislative history.²⁰⁶ However, in holding that GME programs were not "educational," it was necessarily relying on some outdated analysis of the facts and circumstances of such programs.²⁰⁷ Of course, this Note has attempted to show that the presumption should be in favor of GME programs' qualification under the student exemption because these programs *are* educational in nature. But even assuming this to be wrong, a contrasting presumption should not avoid implicitly conducting its own case-by-case analysis. Simply put, it is absolutely necessary to view the student exception

203. See *supra* notes 91–97 and accompanying text (highlighting Judge Kyle's failure to engage in a true *Chevron* analysis).

204. See *supra* Part II.A.3.a (discussing the ambiguity of the term "school, college, or university").

205. *United States v. Detroit Med. Ctr.*, No. 05-71722, 2006 WL 3497312, at *10 (E.D. Mich. Dec. 1, 2006).

206. See *supra* notes 110–15 (discussing the *Detroit Medical Center* court's finding of ambiguity in order to utilize the section's legislative history as an interpretive tool).

207. See *supra* notes 109–12 and accompanying text (discussing the *Detroit Medical Center* court's hasty conclusion that it was generally accepted that GME programs were not educational).

through the lens of the institution seeking the exclusion, and unavoidably, this requires a case-by-case analysis.

A. Framework of Proposal

The nature of GME programs and the accreditation process, coupled with the focus of today's medical education (in contrast with the focus in 1939), strongly suggests that GME be permitted to operate outside the realm of FICA taxation. Such a rule would bring some measure of clarity to FICA taxation in general and would reduce overall costs to GME programs as they will have confidence in their tax exempt status and will be spared significant litigation expenses relating to FICA refund suits. Ultimately, this would lead to more efficient and effective GME programs in the United States. Logically, the overall goal of creating better doctors relies on the educational institution's ability to provide the best facilities, instruction, and exposure to the practice of medicine as possible for its students. Fewer resources wasted on litigating the student exemption issue would enable GME program administrators to pursue superior educational opportunities. If the IRS is permitted repeatedly to haul teaching hospitals and other similar institutions into court for infinite bites at the apple, the whole of the medical education institution would be placed in jeopardy.

It is important to recognize once again the total absence of review of ACGME's GME accreditation standards in the various federal court cases deciding the applicability of the student exception to medical residents. This omission is particularly alarming with respect to the majority approach. An effective case-by-case analysis must require a review of all relevant facts and circumstances, and it seems that ACGME's accreditation standards would be paramount to such an analysis. Of course, those courts employing the majority approach consistently have found that medical residents' stipends are properly excludable under § 3121(b)(10), so any measurable effect that a discussion of the ACGME standards might have would be cumulative.

The IRS has lost the fight with the GME community. Courts finding in favor of the applicability of the student exception to medical residents have rejected nearly every one of the IRS's attempts to disqualify the residents, usually on the ground that the amended regulation offends a fair and reasonable reading of § 3121(b)(10).²⁰⁸ The courts which have found in favor of the

208. See, e.g., *supra* note 90 and accompanying text (discussing the *Mayo I* court's view that residents were exempt under a plain reading of the statute).

government's position resort to legislative history, which is sparse, outdated, and devoid of any real substance.²⁰⁹

It is time for Congress to step in and resolve the dispute over its own intent regarding the student exception under § 3121(b)(10). All other conceivable avenues of resolution have failed: the courts have bifurcated on the appropriate analytical approach; the IRS has been wholly unsuccessful in accomplishing through regulation amendments what it believes is the "clear intent" of Congress; and the medical community remains vulnerable due to insecurity about which path the next federal court will take. In light of the foregoing analysis, this "intent" should manifest in presumptive FICA exemption for medical residents and their sponsoring institutions.

209. See *supra* notes 110–11 and accompanying text (discussing the courts' minority stance that involves utilizing legislative history in order to find the exemption inapplicable to medical residents as a matter of law); see also *supra* note 175 and accompanying text (describing the student exception's minimal legislative history).

