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Tax Issues in Research and Technology

Kelly Farmer

Bertrand M. Harding Jr.

Sean P. Scally

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I. Classification of Researcher an Employee or Independent Contractor

A. How researchers are classified depends on how much control the university has over the person's research activities. If the university has the right to dictate the area of the research and how it is conducted, the person is generally classified as an employee; however, a researcher who retains most of these rights is generally considered an independent contractor.

B. See, for example, Rev. Rul. 57-127, where the IRS held that a foundation exercised sufficient control over a biologist's research to classify him as an employee; and Rev. Rul. 71-292, where the IRS held that a "research associate" who conducted research at a trade association had enough control over his own research activities to be classified as an independent contractor.

II. Classification of Researcher as a Fellow or Employee

A. Another issue in this area is whether the individual's research activities constitute "employment services," which would cause him/her to be classified as an employee, or "independent research," which would result in classifying the individual as a fellow. In this latter case, any stipends or payments made to the researcher would be treated as non-compensatory fellowship payments.

B. Factors that the IRS and the courts have taken into account in making this employee v. fellow determination include:

1. The extent of faculty supervision of the student's work, including planned time schedules and required progress reports;
2. The student's ability to direct the course and direction of the research activities;
3. Whether the student is able to retain any patents or copyrights resulting from his or her efforts;
4. Whether the research services are directly related to the fulfillment of a contractual commitment by the institution;
5. Whether the student is required to work a specified number of hours a week or month on the research project;
6. Whether the stipend payment made to the student was relatively small (generally indicative of a fellowship) or relatively large (generally indicative of compensation); and

7. Whether the institution treated the student as an employee as evidenced by withholding tax on the payments as wages and providing faculty privileges and other employee benefits.

C. NRSA Grants versus Non-NRSA Grants

1. In 2009, the IRS Chief Counsel's office issued a detailed legal memorandum (CCA 200944027) explaining why stipends paid under the National Institutes of Health's National Research Service Award (NRSA) fellowship program were *bona fide* fellowship payments and, therefore, not subject to FICA tax and why stipends paid under certain non-NRSA fellowship programs represented compensation for services and were subject to FICA tax.

2. The university that was the subject of this memorandum protested this decision, and in CCA 201117026 the Chief Counsel confirmed its earlier position in another detailed legal memorandum discussing the differences between NRSA and non-NRSA fellowship programs.

3. In these legal memorandums, the IRS rejected the university's first argument that a fellowship grant cannot be treated as compensation for services rendered, saying that the "label" attached to the program is irrelevant, and that the IRS and the Treasury regulations "have long maintained that an amount is not excludible from gross income under section 117 if it (1) represents compensation for past, present, or future employment services, or (2) enables the recipient to pursue studies or research primarily for the benefit of the grantor."

4. The university's primary argument was that there was little if any substantive difference between the manner in which the NRSA and the non-NRSA programs were conducted, and, therefore, the non-NRSA programs should be nontaxable in the same manner as the NRSA programs.

5. The IRS, however, said that the university supported this position with "scant, and often no, direct evidence."

6. By contrast, the IRS said that its position that there are significant substantive differences between the two types of programs is based on "hundreds of documents," including applications for grants, progress reports, offer letters, and other correspondence. The IRS said that these documents, "are direct evidence of the facts and circumstances of this case, and consistently and unambiguously demonstrate both that [the university's] presentation of the facts and circumstances of the present matter are incorrect, and that amounts [the university] provided to non-NRSA fellows are payments for services under §117(c)." The IRS