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SANTA BARBARA • SANTA CRUZ

VICE PRESIDENT — FINANCIAL MANAGEMENT

OFFICE OF THE PRESIDENT
1111 Franklin Street
Oakland, California 94607-5200

December 16, 2005

CONTROLLERS

Subject: Revised Student FICA Guidelines

Attached is a copy of the revised Student FICA Withholding Procedures, Implementation Guidelines. The Guidelines have been updated to reflect changes published by the Internal Revenue Service in Revenue Procedure 2005-11 and related regulations modifying the student FICA exception. The Guidelines also include a Questions and Answers section addressing numerous issues related to the administration of the student FICA withholding process.

The new withholding procedures are effective with the February 1, 2006 pay date. Detailed implementation instructions will be included with the Payroll/Personnel System modifications, which will be released to locations the first week of January.

If you have any questions, please contact Michael O'Neill at (510) 987-0905.

A handwritten signature in black ink, appearing to read "Anne C. Broome".

Anne C. Broome

Attachment

cc: Senior Vice President Mullinix
Associate Vice President Boyette
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Assistant Vice President Plotts
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STUDENT FICA WITHHOLDING PROCEDURES

Implementation Guidelines

These Implementation Guidelines have been updated to reflect the final regulations published by the Internal Revenue Service on December 21, 2004, which modified the student FICA exception provided under Internal Revenue Code (IRC) section 3121(b)(10). The Guidelines also incorporate the new safe harbor contained in Revenue Procedure 2005-11 for administering the student FICA exception. This revenue procedure supersedes Revenue Procedure 98-16.

Student FICA Exception

Under IRC section 3121(b)(10), services performed by a student in the employ of a college or university are generally exempt from Social Security (OASDI) and Medicare, the two components of the FICA tax, provided that the student is "enrolled and regularly attending classes." The IRS interpretation of this section, as set forth in Revenue Procedure 2005-11, provides that a student employee will be exempt from FICA taxes if the student is enrolled at least half-time, in accordance with the regulations issued by the Department of Education. Revenue Procedure 2005-11 also states that a full-time employee, as defined under the final regulations, is ineligible for the exception. The final regulations provide that an employee whose normal work schedule is 40 hours a week is considered a full-time employee. In addition, as an employee's normal work schedule or actual hours worked *approaches* 40 hours per week, it is more likely that the service aspects of the employee's relationship with the employer will predominate over the educational aspects and that the employee will be ineligible for the student FICA exception.

History of FICA Coverage at UC

Unlike employees of private universities, employees of public universities were not subject to FICA taxes prior to 1986, unless the public university voluntarily entered into an agreement (known as a "Section 218 Agreement") with the Social Security Administration to extend such coverage. The following chronology summarizes the implementation of FICA coverage by the University:

- In 1976, the University entered into an agreement with the State of California to modify the State's Section 218 Agreement with the Social Security Administration to extend FICA coverage to employees who were members of the University of California Retirement System (UCRS). Existing members were allowed to make a one-time election to accept or decline FICA coverage. Employees hired on or after April 2, 1976, who became members of UCRS (now known as the University of

California Retirement Plan, UCRP) were automatically subject to FICA. Under the UCRP regulations, student employees generally are not eligible to become members of the retirement system. Therefore, they were also excluded from participation in FICA.

- The Consolidated Omnibus Budget Reconciliation Act of 1985 extended Medicare coverage on a mandatory basis to all state and local government employees, including University employees, hired after March 31, 1986.
- The Revenue Reconciliation Act of 1990 subsequently extended OASDI (i.e., Social Security) coverage, effective July 1, 1991, to state and local government employees who were not members of a qualified retirement plan. In addition, Medicare coverage was extended to employees who became subject to OASDI by reason of this Act.

In response to the 1990 Act, State Assembly Bill 906 authorized the University to mandate that employees who were not members of UCRP become "safe harbor" participants in the Defined Contribution Plan (DCP), in lieu of contributing to OASDI. As a result, University policy requires that all eligible non-career employees hired or rehired on, or after, October 19, 1992, contribute on a pre-tax basis, 7.5% of their gross wages to the DCP. These employees are also required to contribute 1.45% of their earnings to Medicare, in accordance with the 1990 Act.

Withholding Procedures

To qualify for the FICA exception, students employed by the University must meet the eligibility criteria listed below. Student employees who do not satisfy these criteria must contribute 7.5% of their earnings to the DCP and 1.45% to Medicare. Student employees who meet the criteria are not subject to DCP/Medicare withholding.

1. Minimum Number of Units - Undergraduate Students

To be exempt from withholding, undergraduate students must be enrolled in a minimum of **6 units** in accordance with the Department of Education regulations.

2. Minimum Number of Units - Graduate Students

The minimum number of units required for a graduate student to be exempt from withholding is based upon the **half-time** enrollment requirement established at each campus.

Graduate students enrolled and approved for advancement to doctoral candidacy (i.e., Doctoral II students) are not subject to a units requirement during the academic year, inasmuch as the preparation of a dissertation satisfies the half-time enrollment requirement.

3. Maximum Appointment Percentage

To be exempt from withholding, a student must have a total active appointment percentage, including both fixed and variable appointments, of **less than 80%** time for the month or any partial period within the month. In addition, the student must be enrolled in the minimum number of units (as provided above).

4. Summer Employment

A student employed during the summer is subject to withholding, unless the student is taking the minimum number of units established for Summer Session and has an appointment of less than 80% for the month.

5. Employment During Intersession and Breaks

Withholding is not required during intersession and break periods of **5 weeks or less** as long as the student is otherwise eligible for the exception on the last day of classes preceding the break and is eligible to enroll in classes in the academic period following the break.

Campus requests for exceptions to these procedures must be submitted to the Vice President--Business and Finance for approval.

Questions and Answers

This section includes frequently asked questions and answers related to the administration of the student FICA withholding process.

A. General Eligibility Questions

1) If a career employee enrolls in classes at the University, can the employee become exempt from FICA if he is taking the minimum required course load?

No. According to the State of California's Section 218 agreement with the Social Security Administration, employees hired on or after April 2, 1976, who become members of UCRP are subject to FICA. Under the UCRP regulations, even if a career employee accepts a casual appointment at less than 50% time without a break in service, he retains his membership in UCRP and continues to pay FICA taxes.

If a career employee has a bona fide break in service and is rehired as a casual employee or student academic employee at less than 80% time, the employee may become exempt from FICA if he is taking the minimum required course load.

2) If a student is employed at one UC campus and attending classes at another UC campus, is the student eligible for the FICA exception?

Yes. The UC Student Status Code used in the Payroll Personnel/System (PPS) includes a value to identify a student who is attending classes at a campus other than the location at which she is employed. Such a student will qualify for the FICA exception if she is taking the required number of units, and she provides her Departmental Personnel Assistant (DPA) with proof of registration. If the minimum number of units required for the exception differs at the two locations, the minimum number of units required by the employing campus will be applicable.

The values 5, 6, and 7, may be used to identify students employed at one UC campus and attending classes at another.

3) Is a student employed by UC entitled to the FICA exception if he is attending classes at another university or college?

No. The IRS regulations provide that the exception from FICA applies only to an employee who is enrolled and regularly attending classes at the same school, college, or university at which he is employed.

4) Are University students employed at the DOE Laboratories entitled to the FICA exception?

Yes. Such students may qualify for the FICA exception; they are considered University employees and are attending classes at a UC campus.

5) Will students with F-1 or J-1 visas who are nonresident aliens still be exempt from FICA?

Yes. Nonresident alien employees with Citizenship Status Codes of A, E, N, or S and with F-1 or J-1 visas, or with a Citizenship Status Code of X, are exempt from FICA, regardless of their course load. The definition of these Citizenship Status Codes is as follows:

<u>Code</u>	<u>Definition</u>
A	Nonresident alien from Canada, Japan ¹ , Mexico, or South Korea.
E	Nonresident alien, wages not subject to Federal income tax withholding; income reported on Form 1042S.
N	Nonresident alien, wages subject to income tax withholding; income reported on Form W2.
S	Nonresident alien student employee from India.

¹ Effective January 1, 2006, Japan will be deleted from Citizenship Code “A” and will be included under Citizenship Code “N”.

- X Nonresident alien living and working outside the United States; wages not subject to Federal and State withholding taxes.

Nonresident alien employees who hold F1 or J1 visas, but meet the qualifications for resident alien status for tax purposes, are subject to DCP/Medicare withholding, unless they meet the minimum course load requirement and have an appointment of less than 80% time. Student employees should contact their local Payroll Office if they believe they qualify to become resident aliens.

B. Appointment Questions

1) Will only active appointments with pay be considered in determining whether a student's total appointment percentage equals or exceeds the 80% threshold?

Yes. An active appointment is an appointment with a begin date that occurs on, or before, the current date and with an end date that occurs on, or after, the current date. Inactive (expired or future appointments), without salary appointments, or by agreement appointments will not be considered in determining whether a student's total appointment percentage equals or exceeds the 80% limit.

2) What will happen if a future appointment causes a student's total appointment percentage to equal or exceed the 80% threshold midmonth?

If a student has an appointment of less than 80% for at least one day during the month when the new appointment begins, the student will be eligible for the FICA exception for *that* month.

For example: During the period 10/01 through 12/31, a student is employed as a Teaching Assistant (TA) at 50%. In addition, the TA is approved for a 30% Reader position from 11/15 through 12/31. For the months of October and November, the student employee is not subject to DCP/Medicare withholding. The student's earnings for the month of December, however, are subject to DCP/Medicare withholding.

3) How will a student's appointment be treated if the appointment percentage differs from the distribution percentage, e.g., the appointment is 60% but the distribution equals 80%?

The distribution percentage will not be taken into account in calculating the total appointment percentage. Care should be taken, however, to assign the appointment and distribution percentages correctly.

4) Will the Variable (Fixed/Variable) Code on the appointment line exempt a student from DCP/Medicare withholding?

No. The Fixed/Variable Code is used only to determine if hours or percentages are displayed on the payroll time reporting worksheets or in the Online Time Reporting System. The 80% threshold applies to students with both fixed and variable time appointments.

5) *If a student has an 80% variable appointment, but will only be working 60–70% of the time, will he be exempt?*

No. His appointment percentage, not actual hours worked, will be used to determine his DCP/Medicare withholding status.

6) *If a student has a 70% appointment but works 80% time or more, will the student be subject to DCP/Medicare withholding?*

No. The student's earnings will not be subject to DCP/Medicare withholding. As stated above, the student's appointment percentage, not actual hours worked, will be used to determine his status. Therefore, the appointment percentage should be set to reflect the actual number of hours the department plans to schedule the employee to work.

7) *If a student who has a 50% appointment is scheduled to work 40 hours a week during an intersession period, should the department change the student's appointment percentage during this period?*

No. The student is eligible for the exception during term breaks of 5 weeks or less, regardless of the number of hours worked. Thus, for such breaks it would not be necessary to change the appointment percentage (see section E., Q11).

8) *A student employee who currently is subject to DCP/Medicare withholding submits time for a prior month in which she was not subject to withholding. Will the student be subject to DCP/Medicare withholding on the late pay?*

Yes. The PPS uses the employee's current Retirement System and FICA Eligibility codes established on the Employee Data Base (EDB) to determine an employee's withholding status. Therefore, the late pay for this student employee is subject to DCP/Medicare withholding.

C. Course Load Questions

1) *Will units taken through University Extension be counted toward the minimum units requirement?*

No. Courses taken through University Extension will not be counted toward the minimum units requirement unless a campus provides credit for these courses toward a degree. If this is the case, the campus should ensure that these units are reflected on the Student Information System (SIS) Interface file (see section E).

2) Will a graduate student advanced to candidacy for a masters degree be exempt from the units requirement?

No. The exemption from FICA taxes for students advanced to candidacy applies only to graduate students who are preparing a doctoral dissertation.

3) Will graduate students on filing fee status be exempt from the units requirement?

No. The filing fee is restricted to students who have completed the writing of their dissertation and need only for the dissertation to be approved by their doctoral committee. Students on filing fee status are not considered to be registered students.

4) Will graduate students who are taking qualifying exams be eligible for the FICA exemption?

Yes. Such graduate students are eligible for the exception if they are registered for the minimum number of units.

5) Will students enrolled in Summer Session be required to take the same number of units required during the academic year to qualify for the FICA exemption?

Under Revenue Procedure 2005-11, the half-time requirement is defined in accordance with regulations issued by the Department of Education. Those regulations state that an undergraduate student must take a minimum of 6 units to be considered half-time. This requirement also applies to undergraduate students enrolled in Summer Session.

The minimum number of units required for a graduate student is based upon the half-time enrollment requirement established at each campus. In general, the campuses have established separate units requirements for graduate students enrolled during the academic year and Summer Session.

6) If a student is in his last term prior to graduating and is enrolled in less than the required number of units, is he still eligible for the FICA exception?

Yes. The student must be in his last semester or quarter of a course of study and must be enrolled in the number of units needed to complete the requirements for obtaining a degree, certificate, or other recognized credential, offered by the University. The student must file a request for the exception with his DPA, who will then notify the Payroll Office. This exception will only be granted once.

D. DCP and Medicare Questions

1) How will DCP and Medicare deductions be calculated?

The DCP deduction will be calculated at 7.5% of wages that would otherwise have been subject to OASDI (i.e., Social Security), up to the OASDI wage base limit. The OASDI wage base limit for 2006 is \$94,200.² The Medicare deduction will be calculated at 1.45% of Medicare-covered wages, with no upper limit.

2) *Can a student request a distribution of her DCP contributions if she returns to exempt status?*

No. Under IRS regulations governing in-service distributions, an employee may not receive a distribution of her pre-tax DCP accumulations, unless she separates from service. Thus, any employee who returns to exempt status without a break in service is not entitled to receive a DCP distribution.

3) *If a student employee does not specify an investment option, how will his funds be handled?*

A student employee's DCP contributions will default to the Savings Fund unless he changes the fund designation to redirect his contributions to another fund. He can do this by contacting **Fidelity Investments Tax-Exempt Services Company (FITSCo)**, which provides account and recordkeeping services for the DCP. (See Q7 below.)

4) *When a student's appointment ends, what options does she have for her DCP balance?*

When a student separates from service with the University, she may:

- Request a distribution,
- Arrange for a direct rollover to a traditional IRA or other employer plan
- Keep the money in the Plan *if her balance is at least \$2,000*, or
- Receive retirement income from the Plan, if eligible.

Account balances of less than \$2,000 will automatically be distributed on a quarterly basis to participants who have not previously requested a distribution.

5) *When a student employee receives a distribution of his DCP balance, what taxes are withheld?*

A distribution of DCP accumulations is subject to withholding for Federal and California State income taxes unless the full distribution is directly rolled over to an Individual Retirement Account (IRA) or other qualified retirement plan. A student who receives a distribution during the year will receive a tax statement (IRS Form 1099R) by January 31 of the next year. Such distributions are also subject to withholding for Federal and State income taxes.

6) *Will the distribution be subject to penalties?*

² The OASDI wage limit is adjusted annually by the IRS.

If a distribution is taken before age 59-1/2, Federal and State penalties may apply unless the distribution qualifies as an eligible rollover and the distribution is directly rolled over to an IRA or another employer plan.

7) *Who should student employees contact to obtain information concerning their DCP funds?*

Student employees should contact FITSCo Customer Service at 1-866-682-7787 (a toll free number) or go to its web site at: <https://netbenefits.fidelity.com/>.

8) *What is Medicare?*

Medicare is the Federal health insurance program administered by the Social Security Administration. The program is designed for individuals entitled to Social Security who are age 65 or older (although younger individuals can also qualify, e.g., those receiving Social Security disability benefits.)

E. Payroll/Personnel System and Student Information System Interface Questions

1) *What information will be supplied to the PPS by the SIS interface file?*

The following information will be supplied to PPS through the interface: student name, Social Security Number, date of birth, employee identification number (campus option), student identification number, student type (e.g., undergraduate, graduate, etc.), and number of units.

2) *How will student type and number of units data stored in the SIS be matched with a student employee's PPS data?*

Information supplied from the SIS will be matched against the employee's information stored on the EDB. The match will be based on either the student employee's Social Security Number and date of birth or the employee identification number.

3) *What will happen if the identification data stored in each system does not match?*

If there is not a match between the SIS and EDB identification data (e.g., Social Security Number and date of birth) and the UC Student Status Code on the EDB indicates that the student is an undergraduate or graduate student at the same campus of employment, then the number of units on the student employee's EDB record will be set to zero. The student will then become subject to DCP/Medicare withholding. No change, however, will be made to the Student Status Code on the EDB if the student has a student academic title or a casual/restricted position. Otherwise, the student will be coded as not registered.

If there is not a match of identification data and the UC Student Status Code on the EDB indicates that the student is enrolled at another UC campus, no change will be made to the student's UC Student Status Code, number of registered units, or retirement/FICA status.

4) Can a student's EDB record be updated manually if the information stored in SIS is not up-to-date?

Yes. An employee's EDB record can be updated manually to reflect any missing or incorrect data supplied from the SIS interface file. An exception report will be produced identifying students with invalid data on the SIS interface file. To prevent errors from recurring, procedures should be established so that SIS data can be corrected, as needed.

5) How often will the SIS interface be run?

In accordance with Revenue Procedure 2005-11, the interface should be run at the end of the drop-add period in order to determine if the student is carrying the appropriate number of units for the term. The interface may be run more frequently, at campus option.

6) What will happen if a student employee adds or drops a class after the interface has been run?

The change in the student employee's number of units will not be reflected in PPS until the next interface file is run, unless the individual reports the change to his department and the DPA updates the student's EDB record.

7) Will the interface be run during the Summer Session?

Yes. The Payroll Office will set the number of registered units for all student employees to zero after the end of the spring term and before the start of Summer Session. As a result, student employees will become subject to DCP/Medicare withholding until the campus runs the SIS interface to record the units on the EDB of students enrolled in Summer Session courses. However, when a student has exempt status at the end of the Spring term, and Summer Session begins in the same month in which the Spring term ends (i.e., May or June), then the student will retain his FICA exception for the remainder of that month, even when the number of units taken in Summer Session is less than a half-time load. In such a case, the FICA exception will cease the following month (June, or July, respectively).

8) If the SIS interface file shows fewer units than the student is actually enrolled in and DCP/Medicare is withheld, will the student automatically receive a DCP/Medicare payroll adjustment when the number of units is updated?

No. The campus central office (the Payroll Office or, at some locations, the Benefits Office), responsible for retirement/FICA adjustments must process the payroll adjustment. Local procedures for making such adjustments will determine

the timing of the payroll adjustment for any DCP/Medicare deductions taken in error.

9) *What will happen if a student employee is subject to DCP/Medicare withholding but no withholding occurred? Will the student be subject to a retroactive adjustment?*

In general, adjustments related to course load changes will be made only on a prospective basis; however, retroactive adjustments may be made to correct administrative errors, e.g., a change to correct the Student Status Code on the EDB.

The University is liable for both the employer and employee share of Medicare and is responsible for making adjustments to correct errors for any pay period that falls within the statute of limitations for FICA adjustments (i.e., 3 years, 3 months, and 15 days after the year in which the error occurred).

10) *Who should the employee contact if she feels DCP/Medicare was withheld (or not withheld) due to an administrative error?*

The employee should contact her DPA who will then follow campus procedures for correcting the error.

11) *Does the FICA exception apply during intersession breaks?*

Yes. The exception continues during normal school breaks of 5 weeks or less provided the student is otherwise eligible for the exception on the last day of classes preceding the break and is eligible to enroll in classes in the academic term following the break.

F. Unemployment Insurance (UI) Questions

1) *If the University pays UI for a student during the summer or during periods when he is not registered for the minimum number of units, will he be eligible to collect UI when he is no longer employed?*

Student employees who do not qualify for the FICA exception are subject to UI coverage and may file a claim for UI benefits when they separate from University service. Former student employees must meet the same UI eligibility requirements as other former employees. Such claims may be filed at the nearest Employment Development Department (EDD) field office.

2) *What requirements must be met in order to qualify for UI?*

Currently, for a claim to be valid, the claimant must have at least \$1,300 in covered earnings in one quarter of her base period, or at least \$900 in covered earnings in the base period quarter with the highest earnings and earned at least 1.25 times her high quarter earnings during the entire base period. A base period is defined as a 12-month period ending March 31, June 30, September 30, or December 31,

depending on the month in which the particular benefit year ends. However, these earnings levels are subject to change, and additional requirements, as determined by EDD, also must be met.

3) *How can a former employee obtain additional information on UI?*

Former student employees should contact their local EDD office to obtain additional information. A listing of the nearest office can be found in the "white pages" of the telephone directory under: "Government Listings" - State government offices - Employment Development Department - Unemployment Insurance. Former employees also may request a copy of EDD publication DE 2320, *For Your Benefit - California's Programs for the Unemployed - Job Service, Unemployment, Disability Insurance*. This publication contains information on both the eligibility requirements and the estimated benefit amounts.

G. Other Administrative Questions

1) *In the event of a student's death, which office should the DPA contact?*

Locations should establish procedures to routinely notify the Benefits Office of the death of a student employee in order to ensure proper distribution of any DCP accumulations. Procedures are outlined in Accounting Manual Chapter P-196-25, Payroll: Employee Death Payments, which is available at the following address:

<http://www.ucop.edu/ucophome/policies/acctman/>

Information is also available at the UCOP Human Resources and Benefits website under the "Life/Work Changes" category:

<http://www.atyourservice.ucop.edu/>

2) *Can a student request a refund of his DCP accumulations after the expiration date of her appointment?*

Yes. A student can request a distribution two months after her appointment ends as long as she has not received any pay during this time, is not on an approved leave, and has no future appointments.

3) *Currently, Federal College Work-Study funds cannot be charged for benefits. Is the employer's share of Medicare and UI costs an allowable expense that can be charged to work-study funds?*

Under Federal regulations, the employer's share of Social Security, Workers' Compensation, and UI costs associated with student employment may not be included in determining the Federal share of work-study compensation. Therefore, the employer's share of Medicare and the cost of UI are not allowable expenses that can be charged against work-study funds.