

# Federal-State Reference Guide

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A Federal-State Cooperative Publication

- **Social Security Administration**
- **Internal Revenue Service**
- **National Conference of State Social Security Administrators**

Providing guidelines for social security and Medicare coverage and tax withholding requirements for state, local and Indian tribal government employees and public employers.

**2002 Revision**



The *Federal-State Reference Guide* provides state and local government employers a comprehensive reference source for social security and Medicare coverage and Federal Insurance Contributions Act (FICA) tax withholding issues. This guide is a cooperative effort of the Social Security Administration (SSA), the Internal Revenue Service (IRS), and the National Conference of State Social Security Administrators (NCSSSA).

The 2002 edition supersedes the second edition of the *Federal-State Reference Guide* issued in 1997. This *Guide* originated in July 1995 as a cooperative effort among the Social Security Administration, the Internal Revenue Service, the National Conference of State Social Security Administrators, and in particular the State of Colorado, which spearheaded the effort.

Topics addressed in this publication include determining worker status, public retirement systems, social security and Medicare coverage and benefits, Section 218 Agreements, employment tax laws and more.

All IRS forms and publications referred to in this publication can be ordered free through the IRS at (800) 829-3676. Most can be downloaded through the IRS web site at [www.irs.gov](http://www.irs.gov). The office of Federal, State and Local Governments (FSLG) web site is at [www.irs.gov/govts](http://www.irs.gov/govts). Call the Customer Account Service (877) 829-5500, 8:00 a.m. to 6:30 p.m. ET, Monday through Friday, for an FSLG specialist.

All SSA forms and publications can be downloaded from SSA's web site at [www.ssa.gov](http://www.ssa.gov) or go directly to SSA web pages for state and local government employers at [www.ssa.gov/slge](http://www.ssa.gov/slge). Here you can find contact information for Social Security local offices, regional specialists and State Social Security Administrators. To talk to a Social Security representative call 1-800-772-1213; TTY 1-800-325-0778.

The *Federal-State Reference Guide* is for informational and reference purposes only. Under no circumstances should the content be used or cited as authority for assuming, or attempting to sustain a technical position with respect to employment tax or benefit obligations. The Internal Revenue Code (IRC), Social Security Act (Act) and related regulations, rulings and case law are the only valid citations of authority for technical matters.

Visit the office of Federal, State and Local Governments' web site at [www.irs.gov/govts](http://www.irs.gov/govts) or contact an FSLG specialist in your area for further information on Federal-state tax law.

Note: After many of the Questions & Answers at the end of the chapters, the appropriate agency (SSA, IRS, or State) to contact for more information is identified in brackets following the text.

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## **Chapter 1**

# **Social Security and Medicare Coverage Requirements**

Social security and Medicare Hospital Insurance (HI) coverage and withholding requirements for state and local government employees differ from those of employees in the private sector or the Federal government.

### **Historical Overview — State and Local Social Security**

State and local government employees were excluded from social security coverage from 1935 (the date of the original Social Security Act) until 1950 because there was a legal question regarding the Federal government's authority to tax state and local governments. Beginning in 1951, states were allowed to enter voluntary agreements with the Federal government to provide social security coverage to public employees. These agreements are called Section 218 Agreements because they are authorized by Section 218 of the Act.

All 50 states, Puerto Rico, the Virgin Islands, and approximately 60 interstate instrumentalities have a Section 218 Agreement with SSA. Because of the voluntary nature of Section 218 Agreements, the extent of social security coverage varies from state to state. At the state level, most public employees participate in social security. The major exceptions are state employees of Alaska, Colorado, Louisiana, Maine, Massachusetts, Nevada and Ohio. The largest proportion of uncovered state and local government employees work at the local level. The majority of uncovered local government public employees are police, firefighters and teachers. It is estimated that more than 6 million public employees are not covered for social security.

Significant legal and political changes occurred which eventually resulted in mandatory Medicare coverage for state and local government employees hired (or rehired) after March 31, 1986. Mandatory social security and Medicare coverage for state and local government employees who are not members of a public retirement system and who are not covered under a Section 218 Agreement became effective July 2, 1991.

## **Key Dates**

- 1951** States could voluntarily elect social security coverage for public employees not covered under a public retirement system by entering into a Section 218 Agreement with SSA.
- 1955** States could extend social security coverage to employees (other than police officers and firefighters) covered under a public retirement system.
- 1965** Medicare becomes law. Employees covered for social security under a Section 218 Agreement are automatically covered for Medicare beginning July 1, 1966.
- Apr 20, 1983** Beginning this date, coverage under a Section 218 Agreement cannot be terminated (unless the governmental entity is legally dissolved).
- Apr 01, 1986** Employees hired on or after this date are mandatorily covered for Medicare only, unless specifically excluded by law. For state and local government employees hired before April 1, 1986, Medicare coverage may be elected under a Section 218 Agreement.
- Jan 01, 1987** Beginning this date, State Social Security Administrators are no longer responsible for collecting social security contributions from public employers or for verifying and depositing the taxes owed by public employers. Since that date, public employers pay Federal Insurance Contributions Act (FICA) taxes directly to the Internal Revenue Service (IRS) similar to any private employer.
- Jul 02, 1991** Beginning this date, most state and local government employees are subject to mandatory social security and Medicare coverage, unless they are (1) members of a public retirement system, or (2) covered under a Section 218 Agreement.
- Aug 15, 1994** The Social Security Independence and Program Improvements Act of 1994 established the SSA as an independent agency, effective March 31, 1995. This act increased the FICA exclusion amount for election workers from \$100 to any amount less than the threshold amount mandated by law in a calendar year (\$1,200 for 2002). States were authorized to amend their Section 218 Agreements to increase the FICA exclusion amount for election workers to a statutorily mandated threshold. It also amended Section 218 of the Act to authorize all states the option to extend social security and Medicare coverage to police officers and firefighters who participate in a public retirement system. (Under previous law, only 23 states were specifically authorized.)
- Oct 21, 1998** Public Law 105-277 provided a 3-month period for states to modify their Section 218 Agreements to exclude from coverage services performed by students. This provision was effective July 1, 2000, for states that exercised the option to take this exclusion.

## **Public Versus Private Employers' FICA Responsibilities**

Since the early 1980s, the application of the Social Security Act (Act) and the Internal Revenue Code (IRC) to state and local government employers has changed significantly. At the same time, the roles and responsibilities of the Federal government (SSA and IRS)

and state governments (as State Social Security Administrators) have changed. Social security coverage of state and local employees involves a complex set of laws and regulations that provide for coverage and tax withholding requirements that do not apply to private employers. In addition, the legal responsibilities of state and local public employers have changed over the years, especially since 1983, so a public employee's status may not be the same now as it was in earlier years.

## **FICA Status (Section 218 and Non-Section 218 Coverage)**

Do not assume an entity's FICA status (Section 218 and non-Section 218 coverage) and whether it is in compliance with all applicable laws merely because of the status of a similar entity either in the same or a different state. For Section 218 coverage questions, contact your State Social Security Administrator (see list in Chapter 7). For mandatory coverage questions, contact an IRS FSLG Specialist (see Chapter 9).

To determine the correct coverage, the following must be reviewed:

### Section 218 Agreements:

1. When did the state voluntarily enter into a Section 218 Agreement to elect voluntary social security coverage for a particular political subdivision? What optional exclusions and what coverage groups were listed in that Agreement? Does the political subdivision have more than one modification?
2. Did the state or political subdivision terminate voluntary social security coverage, in its entirety or with respect to any coverage group(s), before April 20, 1983?
3. Has the state elected to provide Medicare HI-only for a particular entity?

### Non-Section 218 Coverage (Public Retirement Systems):

1. Does the state or political subdivision have any employees who were hired prior to April 1, 1986, and are exempt from mandatory Medicare?
2. Does the state or political subdivision have a public retirement system\*? If so, employees who are qualified participants in the public retirement system are not subject to mandatory social security coverage (effective July 2, 1991).

\* Throughout this guide, the term "public retirement system" refers to a retirement system of a state, political subdivision, or instrumentality thereof that meets the requirements of Section 3121(b)(7)(F) of the IRC. See Revenue Procedure 91-40, Appendix.

## **Determining Social Security and Medicare Coverage of State and Local Government Employees**

The following steps outline how a public employer determines whether social security and Medicare coverage or Medicare-only coverage applies to an employee.

**Step 1:** Determine whether the employee's position is covered by a Section 218 Agreement. (Chapter 4, **Social Security Coverage**.) If "yes," the employee is covered for social security and Medicare under the Agreement, unless an exclusion applies. If "no," proceed to the next step.

**Step 2:** If the employee's position is not covered under a Section 218 Agreement, determine whether the employee is a member of a public retirement system. (Chapter 6, **Public Retirement System**.) If "no," the employee is subject to mandatory social security and Medicare, unless an exclusion applies. If the employee is a member of a public retirement system, the employee is exempt from mandatory social security. Medicare is mandatory for public employees hired or rehired after March 31, 1986, regardless of membership in a public retirement system. Proceed to next step to determine Medicare coverage for any employee hired prior to April 1, 1986.

**Step 3:** Determine whether the retirement system has a Section 218 Agreement that provides Medicare only coverage for employees hired prior to April 1, 1986. If "yes," the employee is covered for Medicare only. If "no," proceed to next step.

**Step 4:** Determine whether the Medicare continuing employment exception applies to the employee. (Chapter 5, **Medicare Coverage**.) If "yes," the employee is exempt from mandatory Medicare. If "no," the employee is subject to mandatory Medicare, unless an exclusion applies.

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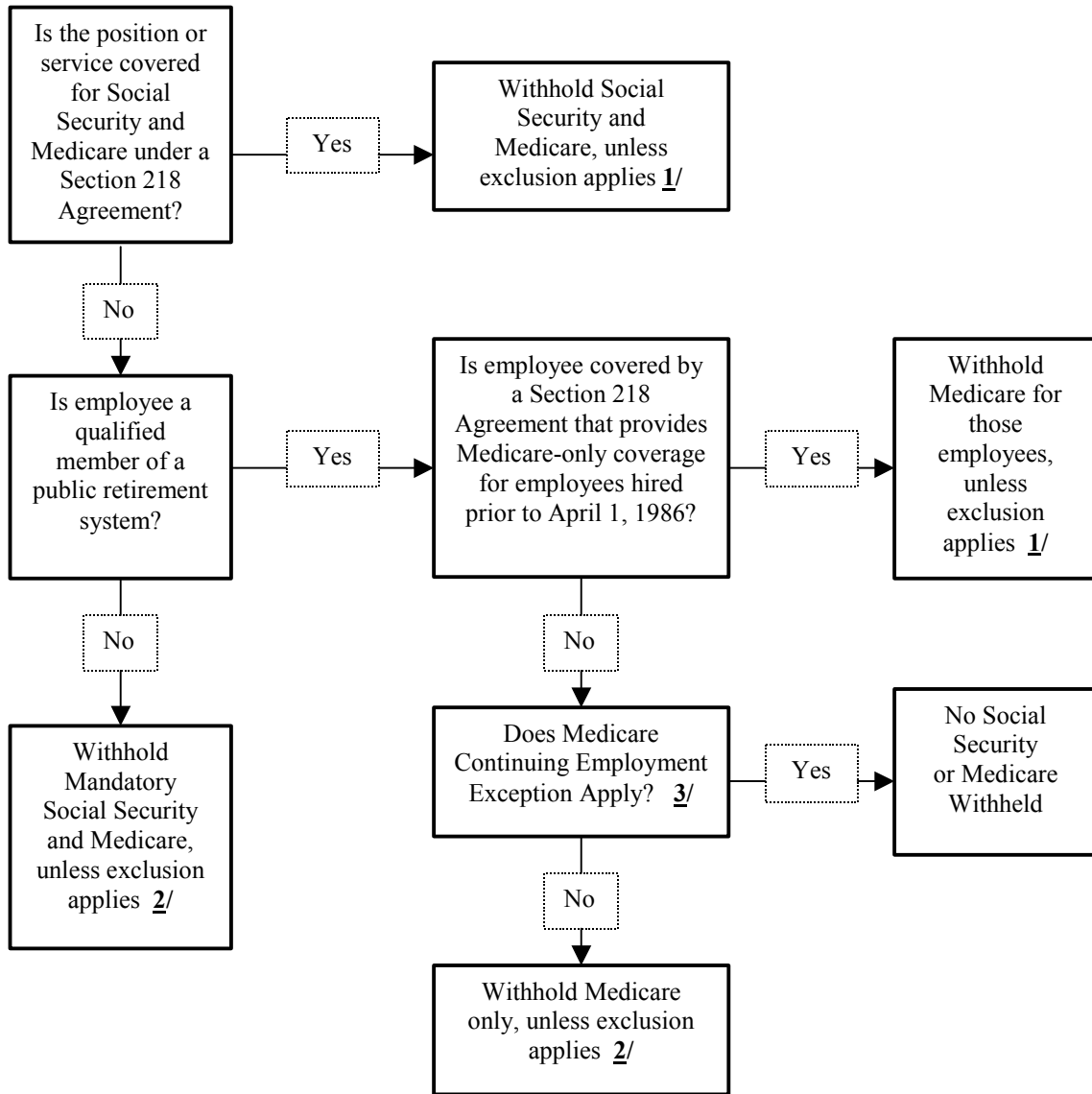
**The flowchart on next page illustrates the above steps.**

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**Note:** Section 218 coverage is based on the position an employee occupies. If the position is covered under a Section 218 Agreement, any employee occupying that position is covered. This is the first coverage consideration an employer makes. If, however, the position is not covered under an Agreement, then the employer must determine whether mandatory FICA coverage applies. To determine mandatory coverage, the employer must look not at the position but at the employee, and determine whether the employee is a member of a public retirement system. This is an important distinction to understand when determining whether and how Section 218 or mandatory FICA coverage applies to an employee.



## SOCIAL SECURITY AND MEDICARE COVERAGE OF STATE AND LOCAL GOVERNMENT EMPLOYEES



- 1/ Section 218 Mandatory and Optional Exclusions** (see Chapter 4, Social Security Coverage)  
**2/ Mandatory Exclusions from FICA** (see Chapter 4, Social Security Coverage)  
**3/ Medicare Continuing Employment Exception** (see Chapter 5, Medicare Coverage)

**NOTE:** This chart is meant as a guide only and is not a substitute for discussing difficult Section 218 coverage situations with your State Social Security Administrator or FICA taxation issues with your IRS FSLG Specialist.

## **IRS, SSA, State Social Security Administrators and Public Employer Social Security and Medicare Tax Responsibilities**

**IRS** – See Chapter 9, **Internal Revenue Service**.

- Administer the Internal Revenue Code (IRC), including the mandatory social security and Medicare provisions under FICA.
- Advise on and enforce reporting requirements for social security and Medicare taxes.
- Advise on and enforce withholding and deposit requirements for social security and Medicare taxes.
- Receive and process Form 941.
- Audit and collect social security and Medicare taxes.
- Define and resolve employment tax liability issues.
- Define and resolve tax issues associated with payment of wages, employment and employee-employer relationship.
- Advise SSA and state administrators of tax issues; clarify issues; and respond to questions from SSA, State Social Security Administrators and employers on tax matters.
- Provide publications and forms required for reporting.

**SSA** - See Chapter 8, **Social Security Administration**.

- Administer the Social Security Act (Act), including interpreting its provisions.
- Review and process Section 218 agreements and modifications.
- Interpret Section 218 Agreements and modifications.
- Define and resolve issues related to social security coverage and benefits, including, but not limited to, defining wages for social security coverage purposes.
- Determine the amount of wages placed on an individual's social security earnings record, and correct erroneously posted amounts, as required by law.
- Provide information about social security and Medicare programs; accept claims for and determine entitlements to those programs.
- Review social security and Medicare coverage, ensuring proper social security coverage and benefit payments.
- Advise IRS and State Social Security Administrators regarding social security and Medicare issues.
- Receive, process annual wage reports (IRS Forms W-2 & W-3 data) from employers.
- Answer reporting questions from employers, whether filing via *e-file*, magnetic media, or paper; and assist employers in reporting correctly.
- Assist employers with resubmission of reports that could not be processed because of format or content problems.

- Answer questions and serve as a liaison with the Annual Wage Reporting Processing Section if a file is returned.
- Assist employers with reconciliation of Form W-3 data with Form 941 totals.

**State Social Security Administrators - See Chapter 7, State Social Security Administrator.**

- Under Section 218 of the Act, the primary legal responsibility State Social Security Administrators have is for Section 218 entities. However, responsibilities for non-Section 218 entities vary from state to state. Some state administrators may not interact with non-Section 218 entities while others may perform monitoring, quasi-regulatory and enforcement functions. If a non-Section 218 entity needs information regarding coverage under an agreement, it should contact the State Social Security Administrator.
- Serve as a bridge between state and local government employers and Federal agencies, including SSA and IRS.
- Administer and maintain the Section 218 Agreement that governs voluntary social security and Medicare coverage by state and local government employers in each state.
- Prepare Section 218 modifications to include additional coverage groups, correct errors in other modifications, identify additional political subdivisions that join a covered retirement system, or obtain Medicare coverage for public employees whose employment relationship with a public employer has been continuous since March 31, 1986.
- Provide SSA with notice and evidence of the legal dissolution of covered state or political subdivision entities.
- Conduct referenda for social security and Medicare coverage for services performed by employees in positions under a public retirement system.
- Resolve coverage and taxation questions associated with Section 218 Agreements and modifications with SSA and IRS.
- Negotiate with SSA to resolve social security contribution payment and wage reporting questions concerning wages paid before 1987.
- Advise the state's public employers on social security and Medicare and tax withholding matters.
- Provide information to state and local public employers as appropriate and in accordance with the state's enabling legislation, policies, procedures and standards.
- Provide advice on Section 218 optional exclusions applicable to the state and/or individual modifications, and advice on state and local laws, rules, regulations and compliance concerns.
- Maintain physical custody of the state's master Section 218 Agreement, modifications, dissolutions and intrastate agreements.

**Public Employers - See Chapter 10, Public Employer Responsibilities.**

- Properly classify workers as independent contractors or employees.
- Determine which employees are exempt from social security and/or Medicare taxes.
- Withhold, report and pay appropriate social security and Medicare taxes, or Medicare-only taxes for each employee.
- Obtain clarifications of laws, regulations and other appropriate information from State Social Security Administrators, IRS, and SSA.

## Chapter 2

# Social Security and Medicare for Public Employees - Frequently Asked Questions

The following questions address some key issues for public employers and employees concerning social security and Medicare. Because of the complexity of issues and unique circumstances of each entity, general questions have been selected. Check the appropriate chapter(s) for more detailed information about specific questions.

1. **What is a Section 218 Agreement?** A Section 218 Agreement is a written voluntary agreement between a state and the SSA pursuant to the provisions of Section 218 of the Act to provide social security and Medicare or Medicare-only coverage for state and local government employees. The term refers to the original agreement and all subsequent modifications. These agreements can cover services of employees who are covered by a public retirement system as well as those who are not. To determine whether your entity is covered under a Section 218 Agreement, or needs to execute one, contact your State Social Security Administrator. See list of state administrators under Chapter 7, **State Social Security Administrators**. [SSA/STATE]
2. **A Section 218 Agreement can cover services of employees who are in a retirement system but how does the Social Security Administration define a retirement system for this purpose? Is it the same definition that the Internal Revenue Service uses?** A retirement system for retirement system group coverage under an Agreement is any pension, annuity, retirement or similar fund or system established by a state or political subdivision to cover the services or positions of its employees. **NOTE:** For a retirement system to be covered under a Section 218 agreement it **does not need to meet minimum benefit levels**. Only a retirement system a state or political subdivision is considering as an alternative to mandatory social security has to meet these minimum standards as required by the IRS. See Chapter 6, **Public Retirement Systems**, and Question 5 below. [IRS]
3. **Are Indian tribal government employers eligible to enter into Section 218 Agreements?** No, Indian tribal governments are not treated as states for this purpose. See IRC section 7871. [IRS]
4. **What is mandatory social security? What is mandatory Medicare?** Prior to July 2, 1991, the only way a state or local government could cover its employees under social security was to include them under the state's Section 218 Agreement with SSA. Beginning July 2, 1991, most state and local government employees whose services are not covered by a voluntary agreement and who are not qualified participants in public retirement system, must be covered for social security and pay social security taxes. This is called *mandatory* social security.

With limited exceptions, other state and local government employees hired (or rehired) after March 31, 1986, must be covered for Medicare and pay Medicare taxes. This is called *mandatory* Medicare.

Employees who have been in continuous employment with an employer since March 31, 1986, who are not covered under a Section 218 Agreement and are not subject to *mandatory* social security, remain exempt from both social security and Medicare taxes (if they are qualified participants in a public retirement system) [IRS]

5. **What is a “public retirement system” as defined by the IRS?** A “public retirement system” or a “retirement system” is a pension plan maintained by a public employer that meets the requirements of IRC Section 3121(b)(7)(F). See Revenue Procedure 91-40 in the **Appendix**, and Section 31.3121(b)(7)-2 of the Employment Tax Regulations. These requirements must be met for a retirement system to be used as an alternative to mandatory social security coverage. See Chapter 6, **Public Retirement Systems** and Question 2 above. A public retirement system is not required to be a qualified plan within the meaning of the Employees’ Retirement Income Security Act of 1974 (ERISA). [IRS]
6. **What determines whether an organization is a public or a private non-profit employer?** Generally, you should consider the provisions of state and local law when determining whether an organization is a public employer or a private non-profit employer. Obtain a copy of the statute under which the entity is created and the legal document creating the entity. When the status of an entity is unclear, the state may request the Attorney General’s opinion concerning whether the entity constitutes a political subdivision under the laws of that state. Some political subdivisions, such as hospitals and libraries, can be both public and nonprofit. Contact the IRS concerning the status of an entity for social security and Medicare purposes. Refer questions concerning the status of an entity for Section 218 purposes to the State Social Security Administrator. Also, see Chapter 10, **Public Employer Responsibilities**, for information on wholly owned instrumentalities of a state or political subdivision. [IRS]
7. **Why don’t all public employees pay social security and Medicare taxes when all private employees are required to do so?** When initially enacted in 1935, the Act did not cover public employees because there was a constitutional question regarding the power of the Federal government to tax state and local governments. In 1950, Congress added Section 218 to the Act to allow states to voluntarily enter into agreements with the SSA to permit coverage for some or all their employees and employees of political subdivisions and interstate instrumentalities. These agreements are known as Section 218 Agreements. [SSA]

8. **Are elected and appointed officials employees?** Elected and most appointed officials are defined by statute as employees of the public entity they serve, e.g., mayors, members of the legislature, county commissioners, city council members and board or commission members. Mandatory social security and Medicare applies unless the official is covered under a Section 218 Agreement or is a qualified participant in a public retirement system. However, all officials elected or appointed to their positions after March 31, 1986, are subject to Medicare withholding. See Chapter 3, **Determining Worker Status**. [IRS]
9. **What is FICA?** FICA stands for Federal Insurance Contributions Act (Chapter 21 of the IRC). FICA taxes include Old-Age, Survivors and Disability Insurance (OASDI) and Hospital Insurance (HI or Medicare) taxes. [IRS]
10. **Are any services excluded from mandatory social security and Medicare coverage under Section 3121(b)(7)(F) of the IRC?** Yes. However, some services excluded under Section 3121(b)(7) of the IRC may be covered by a Section 218 Agreement. See Chapter 4, **Social Security Coverage**. Services are excluded if they are performed by:
- Persons hired to be relieved from unemployment
  - Individuals paid for services performed in a hospital, home, or other institution where they are patients or inmates
  - Employees hired **temporarily** to handle disaster emergencies, such as fire, flood, storm, snow, earthquake
  - Nonresident aliens with F-1, J-1, M-1, or Q-1 visas for services they perform to carry out the purposes for which they were admitted to the United States
  - Public officials compensated solely by fees received directly from the public that are covered by the Self-Employment Contributions (SECA) tax
  - Students enrolled and regularly attending classes at the school, college or university where they are working
  - Election officials and election workers paid less than the threshold amount mandated by law in a calendar year
  - Individuals performing services that would be excluded if performed for a private employer [IRS, SSA]
11. **My entity was never covered under a Section 218 Agreement. Therefore, we have not been subject to social security or Medicare. Why should I care about changes in the laws related to these programs?** Since 1985, there have been significant changes in the social security and Medicare responsibilities of state and local government entities. If an employee is not covered under a Section 218 Agreement, is not a qualified participant in a public retirement system, and is not excluded under Federal law, the employee is subject to social security and Medicare taxes. In addition, any employee hired after March 31, 1986, even if covered under a public retirement system, is subject to Medicare. Requirements vary not only from one entity to another but on an employee-by-employee basis

within the entity. Contact your IRS FSLG Specialist to determine whether you comply with Federal laws. [IRS]

12. **I have a question regarding social security and Medicare coverage requirements. Whom do I contact?** The State Social Security Administrator should always be an entity's first contact on any questions regarding coverage under social security or Medicare. See Chapter 7, **State Social Security Administrators**. [STATE]
13. **Where should questions that begin, "Do we have to pay social security taxes on...?" be directed?** All questions related to tax liability should be directed to the IRS.
14. **Where should questions related to social security and Medicare coverage, benefits, and earnings records be directed?** All questions related to social security and Medicare coverage should be directed to the State Social Security Administrator. Questions concerning social security benefits or correcting earnings records should be directed to SSA.
15. **What are the consequences of misclassifying a worker?** Generally, when an employer erroneously classifies an employee as an independent contractor and does not withhold Federal payroll taxes, the employer could be liable for the employer and employee shares of all applicable Federal payroll taxes, as well as penalties. See Chapter 3, **Determining Worker Status**. [IRS]
16. **What do you do if the status of a worker cannot be determined?** The state or local entity and/or the worker can request a formal determination by submitting, to the IRS, IRS Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*. When Form SS-8 is submitted to the IRS, all the facts are analyzed and the determination of the worker's status is presented to the worker and the service recipient. See Chapter 3, **Determining Worker Status**. [IRS]
17. **I prepare payroll for six individuals. With a question on withholding social security taxes, I called the nearest Social Security office and was told to contact the IRS. Why should I call the IRS if I am asking about social security taxes?** First, contact your State Social Security Administrator to determine whether the services are covered for social security and Medicare. The IRS is responsible for collecting social security and Medicare taxes. Contact the IRS with questions regarding when to withhold social security and Medicare taxes and where and how to pay them. [STATE/IRS]
18. **If the IRS is responsible for answering questions on withholding and paying social security and Medicare taxes, why do we get reporting information from SSA and why do we have to send IRS Forms W-2 to SSA?** People apply to SSA for monthly retirement, disability or survivors benefits. The amount of benefits is based in part on an individual's earnings over his or her working



career. Therefore, SSA must know about those earnings. The information on an individual's earnings record is taken directly from the social security and Medicare wage fields on the Form W-2 sent to SSA by the employer. After SSA processes this information, it is forwarded to the IRS. Either IRS or SSA can help you with reporting questions. [IRS/SSA]

19. **I am the mayor of a small town. Employees of the town have to pay social security taxes. I just learned that a neighboring town stopped paying social security taxes on its employees when it created a pension plan for them. Can we do this?** First, check with your State Social Security Administrator to determine whether your town is covered by a Section 218 Agreement. Social security coverage obtained in this manner cannot be terminated. If your town does not have a Section 218 Agreement, it may be possible to stop paying mandatory social security if your town has a public retirement system. However, employees hired after March 31, 1986, are mandatorily covered for Medicare even if they are qualified participants in a public retirement system. [STATE]
20. **I checked with the State Social Security Administrator and was told that my town is covered for social security under the state's Section 218 Agreement and therefore, the coverage cannot be terminated. Why can't our town stop its coverage?** Since April 20, 1983, coverage obtained under a Section 218 Agreement cannot be terminated. Beginning July 2, 1991, if state and local government employees are not covered for social security under a Section 218 Agreement, and are not qualified participants in a public retirement system, they are mandatorily covered under social security. For employees covered mandatorily, coverage ceases if they become qualified participants in a public retirement system. [STATE/SSA]
21. **How does an employee verify what the SSA shows on her/his earnings record?** An employee may submit Form SSA-7004, *Request for Social Security Statement*, to the SSA. The *Social Security Statement* is mailed annually to workers and former workers aged 25 and older who have worked in covered employment. There is no charge. You can get Form SSA-7004 from any Social Security office, by calling 1-800-772-1213, or through the SSA web site at [www.ssa.gov/mystatement](http://www.ssa.gov/mystatement).
22. **What should an employee do if the earnings information on the Social Security Statement is incorrect?** If an employee has a question or disagrees with the information shown, the employee should contact SSA at 1-800-772-1213.
23. **If board members are paid nominal amounts, for example under \$1,000 per year, must social security and Medicare taxes be withheld?** Elected and most appointed officials are employees of the public entity they serve. Withhold social security and Medicare taxes for any official who is 1) covered under a Section 218 Agreement; or 2) not a qualified participant in a public retirement system.

However, any official elected or appointed after March 31, 1986, is subject to Medicare. [IRS]

**24. My employees are paying into the State Teachers' Retirement System and some have enough social security credits from former employment to be eligible for social security benefits. Will they receive full benefits from both?**

The Windfall Elimination Provision may reduce social security benefits. Additionally, spouses' benefits may be reduced by the Government Pension Offset formula. See Chapter 11, **Social Security and Medicare Benefits**. [SSA]

**25. Our employees' union wants us to begin withholding only Medicare taxes for all employees who are not currently covered for Medicare because they were hired before April 1, 1986. Can we agree with the union to do this?**

If the employees have been in continuous employment with the employer since March 31, 1986, and are members of a public retirement system, a referendum must be conducted by the state for all eligible employees. A modification to the Section 218 Agreement for Medicare-only coverage must be executed by the state and SSA before you begin withholding Medicare taxes. A collective bargaining agreement with the union does not change this requirement. Contact your State Social Security Administrator to prepare a Medicare-only Section 218 Agreement modification. [STATE]

**26. I was told that we have to withhold Medicare even if employees are not covered by social security. Is this true?** Yes, but only for employees hired after March 31, 1986. [IRS/SSA]

**27. How do I get a refund if I paid social security and Medicare tax in error?**

Generally, errors on an IRS Form 941 for a prior quarter are corrected by making an adjustment on the Form 941 for the quarter during which the error was discovered. The adjustment can include both overpayments and underpayments. With Form 941, submit IRS Form 941c, *Supporting Statement to Correct Information*, and any background information and certifications supporting the adjustment to the IRS. The IRS will not be able to process your adjustment(s) without all necessary supporting information.

If the error cannot be adjusted on Form 941, an employer can file a claim for refund by submitting IRS Form 843, *Claim for Refund and Request for Abatement*. Attach Form 941c or an equivalent supporting statement that provides background information.

If social security and Medicare taxes were overcollected from an **employee**, the employer must repay the amount to the employee. The employer must obtain from the employee a written receipt showing the date and amount of the repayment and a written statement that the employee will not claim a refund or credit for the amount. See Chapter 10, **Public Employer Responsibilities**, and IRS Publication 15, *Employer's Tax Guide (Circular E)*, for more detailed information.

The employer may want to contact the State Social Security Administrator first to verify that there has truly been an error. [STATE/IRS]

28. **What is the statute of limitations date for an adjustment or claim for refund of payroll taxes?** The general rule is that an adjustment or claim for refund of any overpayment of Federal payroll taxes must be filed within three years from the date the return was due or three years from the date it was filed, if that date is later. [IRS]
29. **I am the payroll clerk of a new water district that was formed by the merger and dissolution of two other water districts. The new district is providing retirement coverage to the employees through the state's PERS and is also withholding and paying social security and Medicare taxes. What should I do about a Section 218 Agreement?** You should first contact your State Social Security Administrator to determine the social security status of the new and the old water districts. The State Administrator will need to review the legal documentation establishing the new district and terminating the old district, ascertain the necessary procedures to be followed and, working with you, enact the appropriate coverage. Action may also be required by the State Administrator to dissolve the Section 218 coverage for the old districts that are no longer in existence. [STATE]

Note: Generally, employees of a state or political subdivision who are not covered for social security under a Section 218 Agreement but who **are** qualified participants in a public retirement system, are **not** covered for social security even if the employer continues to withhold and report such taxes. However, all state and political subdivision employees, regardless of retirement system status, are covered for Medicare if they were hired or rehired after March 31, 1986.



## Chapter 3

# Determining Worker Status

Generally, when *workers are employees*, the government entity that employs them must withhold and pay employment taxes. Employment taxes consist of Federal income tax withholding and social security and Medicare taxes, which include Old-Age, Survivors and Disability Insurance (OASDI) sometimes called social security, and Hospital Insurance (HI or Medicare). State and local governments do not pay taxes under the Federal Unemployment Tax Act (FUTA) but state unemployment taxes may apply. When a *worker is an independent contractor*, the governmental entity has information-reporting responsibilities, but does not have to withhold and pay employment taxes.

The following text on worker classification emphasizes questions that confront government entities, especially the common-law distinction between employee and independent contractor.

## Workers Covered Under Section 218 Agreements

States can enter into agreements with SSA to provide social security and Medicare coverage for their employees pursuant to section 218 of the Social Security Act (Section 218 Agreements). The first question for a government entity is whether the worker is in a position covered under a Section 218 Agreement. Section 218 Agreements apply only to groups of workers who are employees. If a group of workers is covered under a Section 218 Agreement, the Agreement cannot be terminated or modified to exclude that coverage group. Employees who are not covered under a Section 218 Agreement are subject to social security and Medicare unless they participate in a public retirement system. Medicare taxes apply to wages of all state and local government employees hired after March 31, 1986. See Chapter 4, **Social Security Coverage** and Chapter 5, **Medicare Coverage** for further information.

## Common Law Rules

### Common Law Standard

The common-law rule for determining whether a worker is an employee is whether the service recipient (i.e., the government entity) has the right to direct and control the worker as to the manner and means of the worker's job performance. In other words, does the entity have the right to tell the worker not only what shall be done but how it shall be done? The entity also has some, though less, control over an independent contractor. The difference between an employee and an independent contractor lies in the degree of control. The common-law rule was developed mainly by court decisions. The courts do not always agree about how the rule should be applied. The question of whether

a particular worker is a common-law employee is not always easy to answer, and determinations of employee status are not altogether consistent.

The following charts cover facts that are used to determine worker status, with special emphasis on those affecting government employers. All the facts and circumstances must be considered in deciding whether a worker is an independent contractor or an employee. The facts fall into three main categories: whether the entity has the right to control the behavior of the worker; whether the entity has financial control over the worker; and the relationship of the parties, including how they see their relationship.

**Behavioral Control** - Under this category, facts show whether the entity has a right to direct and control how the worker performs his or her job. Many times, when workers do their jobs satisfactorily, the entity does not appear to exercise much control. The question, however, is whether there is a right to control.

<p>Instructions, Training, and Required Procedures</p>	<p>An employee is generally subject to the government entity's instructions about when, where, and how to work. The employer has established policies, which the workers are required to learn and follow. Training is a classic means of explaining detailed methods and procedures to be used in performing a task. Periodic or ongoing training about procedures to be followed and methods to be used indicates that the employer wants the services performed in a particular manner. This type of training is strong evidence of an employer-employee relationship. For instance, police and firefighters must be trained to comply with departmental rules and regulations. They do not have the independence characteristic of independent contractors. A state statute requires that animal control officers receive state-sponsored training. A statute requires that inspectors of sanitary facilities be trained and state-certified. These facts are indicative of a right to control. Election workers are trained to follow uniform procedures established for the polling place. They are directed by a supervisor. These facts suggest they would typically be employees. Government employees often work subject to regulations and manuals, which specify how their jobs are to be done. Teachers are required to receive periodic training in departmental policies. They are required to attend meetings, to follow an established curriculum, to use certain textbooks, to submit lesson plans, and to abide by departmental policies concerning professional conduct. Some types of training may be provided to either an employee or an independent contractor, including orientation or information sessions about a government entity's policies and voluntary programs for which there is no compensation. A service recipient also has the right to instruct an independent contractor, but not to the same extent.</p>
<p>Government Identification</p>	<p>Government workers may be required to identify themselves by wearing a uniform, driving a marked vehicle, etc. When an individual represents himself or herself as an agent of a government, that gives the individual an appearance of authority. Wearing a uniform, displaying government identification, or using forms and stationary that indicate one is representing a government are highly indicative of employee status. A government is legally responsible for the acts and omissions of its employees. It is not responsible for the acts of independent contractors.</p>

Nature of Occupation	<p>The nature of the worker’s occupation affects the degree of direction and control necessary to determine worker status. Highly trained professionals such as doctors, accountants, lawyers, engineers, or computer specialists may require very little, if any, instruction on how to perform their services. In fact, it may be impossible for an entity to instruct them, since the entity may lack the knowledge and skills to do so.</p> <p>Attorneys, doctors and other professionals can be employees, however. In such cases, the entity may not train the individuals or tell them how to practice their professions, but may retain other kinds of control, such as requiring work to be done at government offices. The entity can still control scheduling, holidays, vacations, and other conditions of employment. Again, consult state statutes to determine whether a professional position is statutorily created. On the other hand, professionals can be engaged in an independent trade, business, or profession in which they offer their services to the public, including government entities. In this case, they may be independent contractors and not employees. In analyzing the status of professional workers, evidence of control or autonomy with respect to the financial details is especially important, as is evidence concerning the relationship of the parties.</p>
Evaluation Systems	<p>Evaluation systems are used by virtually all government entities to monitor the quality of work performed. This is not necessarily an indication of employee status. In analyzing whether a government entity's evaluation system provides evidence of the right to control work performance, consider how the evaluation system may influence the workers’ behavior in performing the details of the job. If there is a periodic, formal evaluation system that measures compliance with performance standards concerning the details performance, the system and its enforcement are evidence of control over the workers’ behavior.</p>

**Financial Control** - This second category includes evidence of whether the entity controls the business and financial aspects of the workers’ activities. Employees do not have the risk of incurring a loss in the course of their work, since employees receive a salary as long as they work. An independent contractor has a genuine possibility of profit or loss. Facts showing possibility of profit or loss include: significant investment in equipment, tools or facilities; unreimbursed expenses, including the requirement of providing materials or hiring helpers; working by the day or by the job rather than on a continuous basis; having fixed costs that must be paid regardless of whether the individual works; and payment based on contract price, regardless of what it costs to accomplish the job.

Method of Payment	The method of payment must be considered. An individual who is paid a contract price, regardless of what it costs to accomplish the job, has a genuine possibility of profit or loss. An individual who is paid by the hour, week, or month is typically an employee. However, this is not always the case; attorneys, for example, usually bill by the hour, even when they work as independent contractors. An individual who is paid by the unit of work, such as a court reporter, may or may not be an independent contractor, depending on the facts.
Offering Services to the Public	Another factor favoring independent contractor status is whether the individual makes his or her services available to the public or a relevant segment of the market. <ul style="list-style-type: none"> <li>• Does the individual advertise?</li> <li>• Does the individual use a private business logo?</li> <li>• Does the individual maintain a visible workplace?</li> <li>• Does the individual work for more than one entity?</li> </ul>
Corporate Form of Business	If the individual is incorporated and observes the corporate formalities, this makes it unlikely that he or she is an employee of the government entity. (A corporate officer will be an employee of the corporation.) The mere fact of incorporation or use of a corporate name, however, does not transform an employee into an independent contractor. There must be a significant non-tax reason for the formation of the corporation.
Part-time Status	The fact that workers work on a part-time or temporary basis, or work for more than one entity, does not make them independent contractors. A part-time, temporary or seasonal worker may be an employee or an independent contractor under the common-law rules.

**Relationship of the Parties** - The third category used to determine worker status is evidence of the relationship between the parties, including how they view their relationship. A written contract is a very important piece of evidence showing the type of relationship the parties intended to create. A written agreement describing the worker as an independent contractor is evidence of the parties' intent. A contractual designation, in and of itself however, is not sufficient evidence for determining worker status. The facts and circumstances under which a worker performs services are determinative. The substance of the relationship, not the label, governs the worker's status (Employment Tax Regulation Section 31.3121(d)-1(a)(3). In addition, if it is unclear whether a worker is an independent contractor or an employee, the intent of the parties, as reflected in the contractual designation, may resolve the issue. The following items may reflect the intent of the parties:

- Filing a Form W-2 indicates the employer's belief that the worker is an employee.
- Doing business in corporate form, with observance of corporate formalities, indicates the worker is not an employee of the government entity.
- Providing employee benefits, such as paid vacation, sick days and health insurance, is evidence that the entity regards the individual as an employee. The evidence is strongest if the worker is provided with benefits under a tax-qualified retirement plan, Section 403(b) annuity or cafeteria plan because by statute these benefits can be provided only to employees.



Discharge or Termination	The circumstances under which a business and a worker can terminate their relationship have traditionally been considered useful evidence on the status of the worker. Today, however, business practices and legal standards governing worker termination have changed. Under a traditional analysis, a government entity's ability to terminate the work relationship at will, without penalty, provided a highly effective method to control the worker. The ability to fire at will is indicative of employee status. In the traditional independent contractor relationship, the government entity could terminate the relationship only if the worker failed to provide the intended product or service, thus indicating that the business did not have the right to control how the work was performed. Today a government entity rarely has complete flexibility in discharging employees. The reasons a government entity can terminate an employee may be limited by law, by contract, or by its own practices. Consequently, inability to freely discharge a worker, by itself, no longer constitutes persuasive evidence that the worker is an independent contractor.
Termination of Contracts	A worker's ability to terminate work at will was traditionally considered to illustrate that the worker merely provided labor and tended to indicate an employer-employee relationship. In contrast, if the worker terminates work, and payment can be refused, or the worker can be sued for nonperformance, this tends to indicate an independent contractor relationship. Today, however, independent contractors may enter short-term contracts for which nonperformance remedies are inappropriate or may negotiate limits on their liability for nonperformance. For example, professionals, such as doctors and attorneys, are typically able to terminate their contractual relationship without penalty.
Nonperformance of Employees	Employers may successfully sue employees for substantial damages resulting from their failure to perform the services for which they were engaged. As a result, the existence of limits on a worker's ability to terminate the relationship, by itself, is no longer useful in determining worker status. On the other hand, a government entity's ability to refuse payment for unsatisfactory work continues to be characteristic of an independent contractor relationship. Because the meaning of the right to discharge or terminate is so often unclear, and depends primarily on contract and labor law, these facts should be viewed with great caution.
Permanency	The permanency of the relationship between the worker and service recipient is relevant to determining whether there is an employer-employee relationship. If a worker is engaged with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence of intent to create an employment relationship. A long-term relationship may also exist between a government entity and an independent contractor. There may be a long-term contract, or contracts may be renewed regularly due to superior service, competitive costs, or lack of alternative service providers. Part-time, seasonal or temporary workers may also be employees under the common law. The fact that workers do not have full-time, permanent status is irrelevant to their classification.

## Summary

In the case of any worker, some facts will support independent contractor status and others will support employee status. This is because independent contractors are rarely totally unconstrained in the performance of their contracts. Also, employees almost

always have some degree of autonomy. The facts need to be weighed as a whole in order to determine whether control or autonomy predominates.

## **Public Officials**

Federal law applies when determining employee classification. One of the most important factors is whether there is a state constitution or statute establishing a position.

State statutes should be reviewed to determine whether they establish enough control for the individual to be classified as an employee. Statutes may state that a specific position is that of a public official, in which case there is likely to be a right to control sufficient to make the individual an employee. Statutes always specify the duties of a public office and generally establish the officer's superiors and subordinates, if any. Statutes establish an official's term of office, sometimes the compensation. They may require that a public official take an oath of office. Statutes often establish general and specific penalties for dereliction of duty. For instance, members of boards who are paid for each meeting they attend may face termination if they fail to attend a certain number of meetings.

Elected officials are responsible to the public, which has the power not to reelect them. Elected officials may also be subject to recall.

A public official has authority to exercise the power of the government and does so as an agent and employee of the government. For this reason, the Supreme Court has held that public officials are employees. A public official performs a governmental duty exercised pursuant to a public law. Buckley v. Valeo, 424 U.S. 1, 141 (1975). A public office is a position created by law, holding a delegation of a portion of the sovereign powers of government to be exercised for the benefit of the public. Metcalf & Eddy v. Mitchel, 269 U.S. 514 (1926).

A mayor, member of a legislature, county commissioner, state or local judge, justice of the peace, county or city attorney, marshal, sheriff, constable, or a registrar of deeds is a public official. Section 1.1402(c)-2(b), Income Tax Regulations. Other examples are tax collectors, tax assessors, road commissioners, members of boards and commissions, such as school boards, utility districts, zoning boards, and boards of health.

As an example of the degree of control under which a public official works, consider city attorneys in State A. State statutes establish the position and define it as that of an officer and employee. These statutes define the duties of the position: the city attorney is required to direct all litigation in which the city is a party, including prosecuting criminal cases; to represent the city in all legal matters in which the city or a city officer is a party; to attend meetings of the commissioners, advise commissioners, mayors, etc., on all legal questions, and approve all contracts and legal documents. A city manager appoints, supervises and controls the work of the city attorney. The city attorney must take an oath of office.

These facts show the importance of state statutes in establishing a right of direction and control of a public official. For the same reason, elected officials are subject to a degree of control that typically makes them employees under the common law. A very few appointed officials may have sufficient independence that they will not be employees.

Many other positions, such as teacher and school superintendent, are established by statute. The duties of these positions like those of public officials are statutorily established. The qualifications, training and policies, which they must observe and enforce, are established by statute or statutorily established public bodies.

### **Other Governmental Characterizations**

A state or Federal agency may have made determinations of employee status for worker's compensation, minimum wage, or other purposes. Different standards may apply to determine worker classification for Federal employment tax purposes. Characterizations based on state or non-tax laws should be weighed with caution, and in some cases disregarded, because the laws or regulations involved may use different definitions of employee or be interpreted to achieve different policy objectives.

### **Identity of the Employer**

In certain cases it is clear that the work in question was performed by employees, but it may not be clear which of two or more entities, organizations or individuals is the employer. This situation may arise when the workers are supplied or paid by one entity but work under the direction of another, e.g., leased workers. The term employer is defined, for income tax withholding and reporting purposes, as the person for whom an individual performs any service of whatever nature as an employee (IRC section 3401(d)). There is an exception, for tax purposes, if the person for whom the individual performs the services does not have control of the payment of the wages. Then, the term employer means the person having control of the payment of the wages (IRC section 3401(d)(1); Section 31.3401(d)-1(f) of the Employment Tax Regulations). When a question is raised about the identity of the employer, all facts relating to the employment must be considered. Copies of any statutory provisions relating to the relationship should be reviewed. If there is any provision in a statute or ordinance that authorizes the employment of the individual and the individual is hired under this authority, the individual is an employee of the governmental entity. If there is no statutory authority, the identity of the employer must be determined under the common-law control test.

### **Special Situations**

***Chore Workers*** - Workers who perform in-home domestic services for recipients of public assistance are sometimes referred to as chore workers. Under common-law rules, these workers would typically be employees of the individuals for whom they provide services because they work in the service recipients' homes under their direction. In some cases, health and welfare agencies assume responsibility for reporting and paying social security and Medicare, FUTA and income tax withholding with respect to these workers. The agencies report these taxes on Forms 941 as agents for the service recipients. See

Notice 95-18, 1995-1 C.B. 300, and Revenue Procedure 80-4, 1980-1 C.B. 581. Agencies must have a separate employer identification number for this purpose.

***Volunteer Firefighters*** - Firefighters who are on call and work regularly but intermittently do not qualify for the social security and Medicare exception for emergency workers defined in IRC section 3121(b)(7)(F)(iii). This exception is only for temporary workers who respond to unforeseen emergencies, e.g. floods. When a worker who is termed a *volunteer* receives compensation, that compensation is wages subject to social security and Medicare tax if the worker is an employee (unless an exclusion applies). For instance, volunteer firefighters may not receive salaries, but they may receive amounts intended to reimburse them for expenses. They may also receive other cash or in-kind benefits that may be wages. Volunteer firefighters can receive tax-exempt reimbursements for their expenses, but these reimbursements must now be under an *accountable plan* within the meaning of IRC section 62(c) and regulations. An accountable plan is one that is designed to reimburse only actual, substantiated business expenses. This provision is effective for tax years after 1988. An accountable plan must (1) require workers to substantiate actual business expenses, (2) allow no reimbursements for unsubstantiated expenses, and (3) require that any amounts received that exceed substantiated expenses must be returned within a reasonable period. Amounts that are termed *reimbursements* but that are not paid under an accountable plan are subject to income and social security and Medicare taxes. Therefore, a *per diem* or fixed amount paid to a firefighter (or other worker), that does not reimburse actual, documented expenses, is includible in income and subject to social security and Medicare.

## **Independent Contractor Reporting Responsibilities**

Independent contractors are subject to social security and Medicare taxes under the Self-Employment Contributions Act (SECA). Payments to independent contractors of \$600 or more during a calendar year must be reported on IRS Form 1099-MISC, *Miscellaneous Income*. Independent contractors are required to provide a taxpayer identification number to the entity that pays them. IRS Form W-9, *Request for Taxpayer Identification Number*, must be provided to them.

The following table indicates primary responsibilities for payers of independent contractors:

1099 Filing Information	<ul style="list-style-type: none"> <li>- Send a copy of Form 1099-MISC to independent contractors (and other required service providers) who were paid \$600 or more during the year by January 31 of the following year.</li> <li>- Form 1096, <i>Annual Summary and Transmittal of U.S. Information Returns</i>, must be sent with Copies A of all paper Forms 1099-MISC. File Forms 1096 and 1099-MISC with the IRS by February 28<sup>th</sup>.</li> <li>- If you are required to file fewer than 250 information returns, you can file them on paper forms. If you are required to file 250 or more information returns, they must be filed electronically or on magnetic media. General instructions for all information returns can be found in one booklet, <i>General Instructions for Forms 1099, 1098, 5498, and W-2G</i>. Also refer to IRS Publication 15, <i>Circular E, Employer's Tax Guide</i>. Both publications are revised annually.</li> <li>-The IRS operates a centralized call site to answer questions about information reporting. If you have questions about reporting, you may call (304) 263-8700.</li> </ul>
Taxpayer Identification Numbers (TINs)	<ul style="list-style-type: none"> <li>-TINs are used to associate and verify amounts that are reported to the IRS with corresponding amounts on tax returns. Therefore, it is important that the proper TIN be sent to the IRS.</li> <li>-A TIN can be either a social security number (SSN) or an employer identification number (EIN).</li> <li>-Electronic IRS Form W-9 can be submitted to the requester if the established system meets IRS requirements.</li> </ul>
Backup Withholding	<ul style="list-style-type: none"> <li>-In some circumstances you are responsible for backup withholding. For payments after December 31, 2001, the rate is 30%. Backup withholding is required in the following situations: a payee does not provide the payer with a TIN; IRS tells the payer that the TIN is incorrect; and IRS notifies the payer that backup withholding is required.</li> <li>-Use IRS Form 945, <i>Annual Return of Withheld Income Tax</i>, to report the withheld amounts. Form 945 is due January 31<sup>st</sup>. See instructions for Form 945 and Publication 15, <i>Circular E</i>, for more information.</li> </ul>
Payments to Corporations and Attorneys	<ul style="list-style-type: none"> <li>- Generally, information reporting is not required for payments to corporations. There are some exceptions which frequently apply to government entities: <ul style="list-style-type: none"> <li>• Medical and health care payments to a corporation in the amount of \$600 or more to each physician or other provider are reportable on Form 1099-MISC.</li> <li>• Attorney fees of \$600 or more to a corporation are reportable on Form 1099-MISC. Since January 1, 1998, there is no exemption from reporting legal payments to corporations.</li> </ul> </li> </ul>

**Note:** Keep copies of information returns you filed with IRS for at least 3 years from the due date of the returns. Keep copies of information returns for 4 years if backup withholding was imposed.

### **Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding**

Sometimes a state or local entity will be unable to determine whether a worker is an employee or an independent contractor. In this case, the IRS will provide a determination. To obtain a determination, file Form SS-8. Either a governmental entity or a worker may submit Form SS-8. The IRS will acknowledge receipt of your Form SS-8 and will also request information from the worker. If a contract has been executed between the worker

and the entity, a copy of the contract should be submitted with Form SS-8. The IRS will generally issue a formal determination to the entity and will send a copy to the worker.

Workers who were incorrectly treated as independent contractors probably treated themselves as self-employed, filing Schedule C and paying SECA rather than social security and Medicare taxes. Workers who are determined to be employees may need to file amended returns to correct errors. Employers who misclassify employees as independent contractors may be held liable for back taxes, penalties and interest.

### **Worker Providing Services as an Employee and as an Independent Contractor**

When individuals provide services as employees, they may not be employees with respect to all services they provide. For instance, a teacher may be retained to remove snow from school property. This individual may be an independent contractor in the snow-removal activity. In order to determine whether the snow-removal activity is an independent trade or business, apply the common law rules. Revenue Ruling 58-505, 1958-2 C.B. 728, explains that, for an individual to work in two capacities, the services must not be interrelated. In other words, an individual does not work in two capacities when the same type of work, such as legal services, is divided into two components, one in an employee capacity, one in an independent contractor capacity. The services and remuneration must be separate. If the services or compensation are interrelated, then the individual is not acting in two separate and distinct capacities.

### **Section 530**

If the IRS audits a government entity, Section 530 of the Revenue Act of 1978 (Section 530) can provide relief from Federal employment tax obligations if certain requirements are met. When Section 530 was enacted, employees of state and local governments received social security coverage only under Section 218 Agreements. Section 530, by its terms, does not apply to controversies between the SSA and states concerning coverage under Section 218 Agreements. Now, however, state and local government employees are subject to social security and Medicare outside the scope of Section 218 Agreements. The IRS position is that government employers, whose workers are subject to mandatory social security and/or Medicare taxes are eligible for Section 530 treatment. See IRC section 3121(b)(7)(F). The purpose of Section 530 is to allow employers who misclassified employees as independent contractors to continue to treat those workers as independent contractors, provided the employer had a reasonable basis for the classification. To qualify for Section 530 treatment, the employer has to fulfill two conditions: (1) having filed all information returns consistent with the worker's being an independent contractor; and (2) not having treated the worker, or any other worker in a substantially similar position, as an employee. Section 530 terminates liability for employment taxes, including social security and Medicare, Federal income tax withholding and any penalties attributable to the liability. See Revenue Procedure 85-18, 1985-1 C.B. 518.

## Section 530 Tests

The first step in any IRS audit involving worker classification issues is to determine whether the entity meets the requirements of Section 530. This is done before any determination of worker classification. If the entity is entitled to treatment under Section 530, it will not have any employment tax liability with respect to the workers at issue.

The government entity must meet the following consistency and reasonable basis requirements to qualify for treatment under Section 530:

Consistency Test	- The entity must have treated the worker, and all workers in substantially similar positions, consistently as independent contractors. This test is comprised of two parts, and both must be satisfied: 1) It must have filed all required Forms 1099 for the worker ( <i>reporting consistency</i> ); 2) It must have always treated this worker, and all workers in substantially similar positions, as independent contractors ( <i>substantive consistency</i> ).
Reasonable Basis Test	- A government entity that satisfied the consistency tests must also have had a reasonable basis for classifying the worker(s) as independent contractors. It can establish it had a reasonable basis by showing that it relied on: judicial precedent or published rulings; a prior IRS audit; an established, longstanding practice in the industry, or another reasonable basis. These criteria for reasonable basis are often called safe havens. An entity, that can establish consistent treatment (reporting consistency and substantive consistency) and also qualify for a safe haven, is allowed to continue treating the worker(s) as independent contractors.

**Note:** Section 530 is not part of the IRC. It was originally intended as an interim relief measure, but was extended indefinitely in 1982.

## IRS Must Consider Section 530

It is not necessary for the government entity to claim Section 530 treatment for it to be applicable. IRS personnel must provide the taxpayer a plain language summary of Section 530 at the beginning of an examination involving worker classification. Additionally, the government entity need not concede or agree that the workers are employees in order to get Section 530 treatment. The IRS will consider Section 530 as the first step in any case involving worker classification. A government entity will also want to consider this possibility.

## Tax Consequences For Workers

A government entity may be entitled to relief under Section 530, but workers may find, through a determination letter or some other means, that they have been misclassified and are employees. Section 530 relief does not extend to workers. It does not convert them from employees to independent contractors. Misclassified employees are liable for the employee share of social security and Medicare rather than for SECA tax. If they have been filing income tax returns as independent contractors, they should file amended returns for years for which the statute of limitations is open. As employees, they are not

entitled to deduct employee business expenses on Schedule C. Since their employers are entitled to continue treating them as independent contractors, the workers will not be eligible for income tax withholding and will have to make estimated tax payments.



Consistency  
Tests

***Reporting Consistency: Filing Information Returns***

- The first requirement an entity must meet to obtain treatment under section 530 is timely filing of all required Forms 1099 with respect to the worker for the period. The provision applies only for the period. See Revenue Procedure 85-18, Section 3.03(b).  
Therefore, if a government entity in a subsequent year files all required Forms 1099, then it may qualify for Section 530 treatment for the subsequent period.
- If a government entity is not required to file Forms 1099, Section 530 treatment will not be denied on the basis that the returns were not filed. Revenue Ruling 81-224, 1981-2 C.B. 197, addresses specific questions about timely filing of Forms 1099. It provides that:
  - Employers that do not file timely Forms 1099 may not obtain treatment under Section 530 for that worker for that year.
  - Employers that mistakenly, in good faith, file the wrong type of Form 1099 do not lose eligibility for Section 530.

***Substantive Consistency: Substantially Similar Position***

- The entity must never have treated the worker in question, or any worker in a substantially similar position, as an employee.
- A position is substantially similar if the job functions, duties, and responsibilities are substantially similar and the control and supervision of those duties and responsibilities are substantially similar. The determination of whether workers hold substantially similar positions requires consideration of the relationship between the employing entity and the individuals. This includes, but is not limited to, the degree of supervision and control.
- The determination of what is substantially similar work rests on analysis of the facts. The day-to-day services that the worker performs and the method by which they are performed are relevant in determining whether two positions should be treated as substantially similar.
- Comparison of job functions is important. Workers with significantly different, though overlapping, job functions are not substantially similar.

**Defining Treatment** - What is meant by treatment that is consistent (or inconsistent) with independent contractor status?

1. The withholding of Federal income tax or social security and Medicare tax from a worker's wages is treatment of the worker as an employee, whether or not the tax is paid to the government.
2. Filing any of Forms 940, 941, 942, 943 or W-2 with respect to a worker, whether or not tax was withheld from the worker, is treatment of the worker as an employee for that period. Revenue Procedure 85-18.
3. The filing of a delinquent or amended employment tax return for a particular tax period is not treatment as an employee if the filing was a result of IRS compliance procedures. However, filing returns for periods after the period under audit is treatment of the workers as employees for those later periods, regardless of the time at which the return was filed.
4. Neither the preparation of a return by the IRS when no return was filed, nor the signing of IRS Form 2504, *Agreement To Assessment and Collection of Additional Tax and Acceptance of Overassessment*, constitutes employee treatment.

**Treatment for State Purposes** - Only Federal tax treatment as an employee is relevant to Section 530. Thus, if a government entity treats workers as employees for state withholding tax purposes, that is not treatment for purposes of Section 530. However, if the government entity uses a Federal form, such as Form W-2, to report state tax withholding, the filing of the Federal form is treatment for purposes of Section 530.

**Changing Treatment of Workers** - If the government entity begins to treat misclassified workers as employees, relief is available under Section 530 for the prior years when it treated them as independent contractors, provided it satisfied all the requirements of Section 530. See Revenue Procedure 85-18, Section 3.04.

**Dual Status** - Some workers perform services in more than one capacity. For example, a bookkeeper might be separately engaged to design and print educational materials. The fact that the bookkeeper is treated as an employee with respect to bookkeeping services does not preclude application of Section 530 if it is determined that the bookkeeper is an employee, and not an independent contractor, with respect to the design and printing of educational materials.

Reasonable  
Basis Tests

***Judicial Precedent, Published Ruling Safe Haven***

One reasonable basis for independent contractor treatment is reliance on judicial precedent or published rulings. Reliance on judicial precedent means reliance on a court case published before the decision was made to treat the worker as an independent contractor. Reasonable basis may also be established by reliance on a technical advice memorandum, private letter ruling, or determination letter issued to that particular entity. Published rulings are IRS revenue rulings intended for use by all employers. Rulings by state administrative agencies, including agencies that regulate employment, and rulings by Federal agencies other than the IRS cannot be relied on as a reasonable basis.

***Prior Audit Safe Haven***

Another reasonable basis for independent contractor treatment is reliance on a prior IRS audit. An audit prior to 1997 may have been conducted for any purpose. However, taxpayers may not rely on an audit begun after December 31, 1996, unless the audit included an examination of employee status for employment tax purposes. The prior audit safe haven does not apply if the relationship between the government entity and the workers is substantially different from that which existed at the time of the audit. A government entity will be able to claim that it was subject to a prior audit if the IRS previously inspected its books and records. Mere inquiries or correspondence from an IRS Customer Service Center will not constitute an audit.

Audits conducted by agencies other than IRS will not qualify a government entity for relief based upon the prior audit safe haven.

***Industry Practice Safe Haven***

Another reasonable basis for independent contractor treatment is reasonable reliance on a long-standing recognized practice of a significant segment of the industry in which the taxpayer is engaged. The practice need not be uniform throughout the entire industry. The industry-practice safe haven was designed with businesses in mind, and there is no authority on how this standard applies to governmental entities. There are no judicial precedents dealing with Section 530 as applied to governments.

***Other Reasonable Basis Safe Haven***

Another reasonable basis for treatment of workers as employees is reliance on the advice of an attorney or accountant.

## **Interest and Penalties**

### **Interest**

Interest is assessed on any taxes due and unpaid, in addition to any penalties that may be imposed. Specific provisions allow an employer who has made an undercollection or underpayment of social security and Medicare taxes or income tax withholding to make an interest free-adjustment (IRC section 6205(a)(1)). The following two requirements

must be met: 1) Correction of the error must be made in the period in which the error was ascertained; and 2) Payment of the tax must be made no later than the due date of a like return for the return period in which the error was ascertained (e.g., quarter ended March 31 is due April 30). In addition, additional tax due as a result of an IRS examination or ruling may qualify for an interest-free adjustment.

## Penalties

**Employment Tax Penalties** - The following are the most commonly assessed penalties as they relate to employment tax. There are penalties for filing a return late and paying or depositing taxes late unless there is reasonable cause.

<b>IRC</b>	<b>Penalty assessed for:</b>	<b>Penalty Rates:</b>
Section 6651(a)(1)	Failure to file a tax return (failure to timely file)	5% of the tax due per month up to 25%
Section 6651(a)(2)	Failure to pay tax shown on the return (failure to timely pay) (imposed if the amount of tax shown on the return is not paid on or before the prescribed date)	.5% (one half of one percent) of the tax due per month up to 25%
Section 6651(c)	Both failure to timely file and failure to timely pay	When both penalties apply for any month, the failure to file penalty is assessed at 4.5%
Section 6652	Failure to file certain information returns and registration statements, etc. (failure to file information returns not covered under other sections)	Imposes a penalty for tip income unreported to the employer; the penalty is 50% of the employee social security and Medicare tax on the unreported tip income
Section 6656	Failure to make deposit of taxes on the date prescribed (failure by any person to deposit in a government depository)	The penalty for failure to make deposit of taxes is assessed when there is a failure to timely deposit, in the prescribed manner, the correct amount of taxes a) 1-5 days late = 2% b) 6-15 days late = 5% c) More than 15 days, but paid by the 10 <sup>th</sup> day after notice and demand (notice and demand date is the assessment date (23C date) = 10% d) Taxes still unpaid after the 10 <sup>th</sup> day following notice and demand =15%
Section 6662	Underpayment of employment taxes due to disregard of the rules and regulations (accuracy-related)	The penalty is 20% of the underpayment attributable to negligence or disregard of rules and regulations

**Information Reporting Penalties** - The following are the most commonly assessed penalties as they relate to information reporting:

<b>IRC</b>	<b>Penalty assessed for:</b>	<b>Penalty Rates:</b>
Section 6721	Failure to file correct information returns on or before the required filing date or failure to include all information required to be shown on the return (or where there is incorrect information shown)	The penalty for failure to file information reports without all required and correct information (including missing, incorrect and/or unissued TINs) is \$50 for each failure to a maximum of \$250,000 per calendar year
Section 6722	Failure to furnish correct payee statements on or before the date prescribed to the person to whom such statement is required to be furnished, or a failure to include all of the information required to be shown on the payee statement or where the information is incorrect	When there is failure to furnish a timely and correct payee statement, the penalty is \$50 for each failure, not to exceed \$100,000 per calendar year
Section 6723	Failure to comply with other specific information reporting requirements on or before the prescribed time (usually related to failure to furnish a TIN)	When there is failure to comply with any information reporting requirement, the penalty is \$50 for each failure, not to exceed \$100,000 per calendar year



## Chapter 4

# Social Security Coverage

State and local government employers are subject to complex laws and regulations in determining whether their employees are covered for social security and Medicare. A public employee can be covered for social security and Medicare, Medicare only or be exempt from both. Public employees are covered for Social Security under a Section 218 Agreement or under the mandatory FICA provisions. The flowchart *Social Security and Medicare Coverage of State and Local Employees* in Chapter 1 illustrates the process for determining social security and Medicare coverage.

### History

When initially enacted in 1935, the Social Security Act (Act) did not include public employees in social security coverage because of the constitutional question of whether the Federal government could tax state and local governments. Because many government employers did not have their own retirement systems, in 1950 Congress added Section 218 to the Act to allow states to enter into voluntary agreements with the Federal government under which states could provide social security coverage for state and local government employees not covered by a retirement system. These agreements are called **Section 218 Agreements** because they are authorized by Section 218 of the Act. In 1954, the Act was expanded to allow state and local government employees (except police officers and firefighters) who were members of a retirement system to be covered by social security, provided coverage was also authorized by the state and approved through a voluntary referendum of all retirement system members. In 1956, the Act was amended to permit designated states to extend coverage to police officers and firefighters covered by a retirement system. The 1956 Act also authorized certain states to divide retirement systems into two separate groups: those who desired coverage and those who did not.

### Termination of Agreements

Before legislation enacted in 1983, states could terminate coverage for any group of employees covered under the state's Section 218 Agreement. A state did this by providing a two-year advance notice to the Federal government. Once it was terminated, the coverage for this group of employees could not be reinstated. The 1983 Social Security Amendments rescinded this provision of the Act and prohibited states from terminating coverage on or after April 20, 1983, but permitted states to cover again any group terminated before this date.

### Collection and Payment of Social Security and Medicare Taxes

In 1986, Congress enacted the Omnibus Budget Reconciliation Act (OBRA) of 1986. Prior to 1987, SSA was responsible for ensuring that each state paid the correct amount

of social security contributions for all employees covered by its Section 218 Agreement. The State Social Security Administrators were responsible for ensuring that state and local government employers filed timely and accurate returns and that they collected and paid the proper amount of social security contributions to the Federal government. Effective January 1, 1987, state and local governments are required to file quarterly Form 941, *Employer's Quarterly Federal Tax Return*, with IRS. IRS is responsible for the collection of social security and Medicare taxes, the verification of the amount owed and the determination that the amount owed has been deposited. See IRS Publication 15, *Employer's Tax Guide* (Circular E).

### **Mandatory Social Security and Medicare**

Before July 2, 1991, state and local government employers (through action by the state) could voluntarily cover their employees. Under the Omnibus Budget Reconciliation Act (OBRA) of 1990, Congress amended the IRC and the Act so that wages paid to state and local government employees who are not qualified participants in a public retirement system are generally subject to social security and Medicare taxes for service performed after July 1, 1991. Employees hired or rehired after March 31, 1986, and currently covered under the Medicare portion of FICA remain subject to that tax regardless of their membership in a retirement system. See Chapter 5, **Medicare Coverage**. Employees covered by social security under a Section 218 Agreement are automatically covered.

The following chronology lists important legislative developments:



<b>1935</b>	Social Security Act passed.
<b>1950</b>	States and interstate instrumentalities allowed, on a voluntary basis beginning in 1951, to extend Social Security coverage to state and local government employees not under a retirement system by means of a Section 218 Agreement with the Federal government.
<b>1954</b>	Coverage expanded to allow states, on an elective basis, to cover state and local government employees under existing retirement systems, except police and firefighters.
<b>1956</b>	Certain states permitted to divide a retirement system and cover only those employees who desire coverage and new members. Certain states also permitted to cover police and firefighters covered under a retirement system.
<b>1965</b>	Medicare became law. Employees covered for social security under a Section 218 Agreement automatically covered for Medicare beginning July 1, 1966.
<b>1972</b>	States permitted to modify their Agreements before 1974 to exclude: 1) services of state or political subdivision employees in part-time positions; and/or 2) services performed by students working at the school, college or university where they are enrolled and regularly attending classes. Once the Agreement was modified to exclude such services, the state could not again modify it to extend coverage to them.
<b>1983</b>	States no longer permitted to terminate Section 218 Agreements after April 19, 1983. Those that withdrew in the past are allowed to opt in again.
<b>1985</b>	Medicare HI-only coverage mandated for most state and local government employees hired or rehired after March 31, 1986.
<b>1986</b>	Services covered under a Section 218 Agreement treated as employment for purposes of FICA, effective for wages paid after December 31, 1986. Responsibility for collection of social security tax transferred from SSA and the states to the IRS beginning January 1, 1987. Each state and political subdivision became responsible for FICA tax collection and payment to the IRS, like private employers.
<b>1990</b>	Social security and Medicare coverage made mandatory for most state and local government employees not covered by a public retirement system or a Section 218 Agreement. Effective July 2, 1991.
<b>1994</b>	SSA established as an independent agency, effective March 31, 1995. FICA exclusion amount for election workers increased from \$100 to any amount less than the threshold amount mandated by law in a calendar year. All states given the option to extend social security and Medicare coverage to police officers and firefighters who participate in a public retirement system.
<b>1998</b>	States provided a 3-month period in 1999 to modify their Section 218 Agreements to exclude services performed by students from coverage. Effective July 1, 2000, for states that exercised the option.

## Section 218 Agreements

State and local government employees can be covered for social security and Medicare through an Agreement between the state and SSA to:

- Provide social security and Medicare coverage for non-retirement system coverage groups and retirement system groups.
- Provide coverage for services that are excluded from mandatory coverage provisions, but are optional exclusions under Section 218 Agreements, e.g.,

student services and services of election officials and election workers who earn less than the threshold amount mandated by law for a calendar year.

- Provide Medicare HI-only coverage for employees hired prior to April 1, 1986, who are members of a public retirement system.

Each state’s original Section 218 Agreement (“Agreement”) incorporates the basic provisions, definitions, and conditions for coverage. Additional coverage is provided by *modifications*. Each modification, like the original Agreement, is binding upon all parties. *The initiative for securing coverage lies with the state.*

There must be authority under Federal law and state law (state enabling legislation) to enter into an Agreement and to extend coverage under an Agreement. The types and extent of coverage provided under an Agreement must be consistent with Federal and state laws.

State and local government employees who are covered under an Agreement have the same benefit rights and responsibilities as other employees who have social security coverage. The cost of providing social security protection for state and local government employees is the same as for employees mandatorily covered under the Federal Insurance Contributions Act (FICA).

Coverage under an Agreement must be provided for employees by *groups*. An Agreement may be modified to *increase* the extent of coverage but **not** to *reduce* the extent of coverage. (An exception applies to election worker services and solely fee-based positions; see **Optional Exclusions** below.)

## Coverage Groups

Coverage under Section 218 Agreements can be extended only to groups of employees known as coverage groups. Once a position is covered under a Section 218 Agreement, any employee filling that position is covered for social security and Medicare. There are two types of coverage groups: 1) absolute coverage groups (non-retirement system groups); and 2) retirement system coverage groups. Each state decides, within Federal and state law, which groups to include under its Agreement and when coverage begins. The state can choose to cover non-retirement system groups, retirement system groups, or both.

Absolute  
Coverage  
Groups

Also known as non-retirement system groups or Section 218(b)(5) groups. This group includes the services of all employees in positions not covered by a retirement system except those whose services are mandatorily or optionally excluded. A state may extend Section 218 coverage to a non-retirement system group without considering the desires of the employees. Each of the following constitutes an absolute coverage group:

- 1) All employees of a state engaged in performing services in connection with governmental (nonproprietary) functions
- 2) All employees of a state engaged in performing services in connection with a single proprietary function

	<ol style="list-style-type: none"> <li>3) All employees of a political subdivision of a state engaged in performing services in connection with governmental (nonproprietary) functions</li> <li>4) All employees of a political subdivision of a state engaged in performing services in connection with a single proprietary function</li> <li>5) Certain civilian employees working with the National Guard of a state</li> <li>6) Individuals employed under an agreement between a state and the United States to perform services as inspectors of agricultural products</li> </ol>
Retirement System Coverage Groups	<p>These groups consist of employees working in positions covered by a public retirement system (Section 218(d)(4) of the Act). A group covered by a retirement system may be covered under an Agreement only after a referendum is held. The Act gives the state the option, for referendum purposes, of breaking down a retirement system into component parts. If a retirement system covers positions of employees of the state and positions of employees of one or more political subdivisions of the state, the state has the following choices. It may hold a referendum for:</p> <ol style="list-style-type: none"> <li>1) Employees of the entire system</li> <li>2) State employees and a separate referendum for employees of political subdivisions the state wishes to cover</li> <li>3) Employees of any one political subdivision or any combination of political subdivisions</li> <li>4) State employees and combine in the same referendum employees of any one or more political subdivisions</li> <li>5) Employees of a hospital that is an integral part of a political subdivision or of two or more political subdivisions, or the employees of two or more hospitals each of which is an integral part of the same political subdivision</li> <li>6) Employees of each institution of higher learning</li> </ol>
Divided Retirement System Coverage Groups	<p>The Act authorizes certain states and all interstate instrumentalities to divide a retirement system established by the state, a political subdivision thereof, or an interstate instrumentality based on whether the employees in positions under that system want social security coverage. The states having this authority under Section 218(d)(6)(c) of the Act are: Alaska, California, Connecticut, Florida, Georgia, Hawaii, Illinois, Massachusetts, Minnesota, Nevada, New Jersey, New Mexico, New York, North Dakota, Pennsylvania, Rhode Island, Tennessee, Texas, Vermont, Washington and Wisconsin.</p>

### Coverage for Employees under Retirement Systems

Majority Vote Referendum	<p>Under this type of referendum, social security coverage may be extended to employees in positions covered by a retirement system only if a majority of the eligible employees vote in favor of such coverage. A majority of all of the eligible employees under the system, rather than a majority of the eligible employees voting, must favor coverage. All states are authorized by Federal law to use the majority vote referendum procedures. Although the referendum itself is a state matter, Federal law requires that the following conditions be met:</p> <ol style="list-style-type: none"> <li>1) eligible employees are given not less than 90 days notice of the referendum</li> <li>2) an opportunity to vote is given and limited to eligible employees</li> <li>3) the referendum is held by secret ballot</li> <li>4) the referendum is supervised by the Governor (or his/her designee)</li> <li>5) a majority of the retirement system's eligible employees voted for coverage</li> </ol> <p>The referendum procedures must be conducted under the direction of</p>
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	the State Social Security Administrator.
Divided System Retirement Referendum	States authorized to use the divided retirement system to extend coverage may use either of two voting procedures. Most states prefer to use the one-step procedure polling all eligible members and dividing the system into two parts on the basis of the members' choice. The state may also subdivide the retirement system into two parts or systems based on the members' choice. The conditions for a divided vote referendum are the same as those given for the majority vote referendum with one exception. The ballots are not secret since the individuals choosing coverage must be identified.  The referendum procedures must be conducted under the direction of the State Social Security Administrator.

**Continuation of Section 218 Coverage**

Non-Retirement System Coverage	Coverage for non-retirement system groups continues unless the entity ceases to exist. Coverage continues even if the positions are later placed under a retirement system. (This includes police and firefighter positions that were first covered as an absolute coverage group.)
Retirement System Coverage	Coverage for retirement system coverage groups continues as long as the covered positions exist. It continues although the positions are later removed from under a retirement system, the system is abolished, or the positions are placed under another retirement system. Under a divided retirement system, employees carry the <i>no</i> or <i>yes</i> vote with them if they transfer to another position within the same retirement system.

**Mandatory Exclusions** - Certain services are excluded from mandatory **and** voluntary coverage by Federal law. Other services, however, while excluded from mandatory coverage under Section 210 of the Act are only optional exclusions under Section 218 and, therefore, may be covered under a voluntary Section 218 Agreement.

These include services of:

- certain students enrolled and regularly attending classes at the school, college or university where they are working
- election workers paid less than the threshold amount mandated by law
- individuals compensated solely by fees
- certain agricultural workers

If such services are covered under a Section 218 Agreement, they are subject to social security and Medicare under the terms of the Agreement because coverage under a Section 218 Agreement supersedes all other considerations. It is therefore critical to first determine whether a worker's services are covered under an Agreement; if not, then coverage is determined under the mandatory coverage and exclusions rules.

**Note:** A Section 218 Agreement cannot cover services performed by transportation system employees who are covered mandatorily under Section 210(k) of the Social Security Act.

Generally, positions optionally excluded by a Section 218 Agreement must be covered under a public retirement system or under the mandatory FICA provisions. (See next section, **Optional Exclusions.**)

Exclusions from mandatory and voluntary coverage under the Social Security Act (Sections 210(a) and 218(c)(6)) follow. Those exclusions from mandatory coverage that are optional exclusions and may be covered under a voluntary Agreement are so noted:

- Services performed by individuals hired to be relieved from unemployment. The exclusion does not include services performed by individuals under work-training or work-study programs that are designed to provide work experience and training to increase the employability of the person because the primary intent of such programs is not to relieve them from unemployment.
- Services performed in a hospital, home or other institution by a patient or inmate thereof as an employee of a state or local government. Generally, services performed by inmates in a state prison or local jail are excluded from coverage, whether or not the services are performed outside the confines of the prison or jail, because the inmates are normally not in an employment relationship with the state or political subdivision. However, services performed by inmates outside the prison or jail for an entity other than the state or local government operating the prison or jail, such as on a work-release program, may be covered if an employment relationship exists. SSA determines the employer under the common-law rules, discussed in Chapter 3. **Note:** Services performed by patients or inmates as part of the rehabilitative or therapeutic program of the institution are not usually performed as employees.
- Services performed by an employee hired on a temporary basis in case of fire, storm, snow, earthquake, flood or similar emergency.
- Services performed by a nonresident alien temporarily residing in the U.S. holding an F-1, J-1, M-1 or Q-1 visa, when the services are performed to carry out the purpose for which the alien was admitted to the U.S.
- Services performed in a position compensated solely by of fees received directly from the public, by an individual who is treated by the municipality as self-employed. (A state may optionally include the position under a Section 218 Agreement.) See section **Fee-Based Public Officials** below.
- Services by students enrolled and regularly attending classes at the school, college or university where they are working. (A state may optionally include these services under a Section 218 Agreement.)
- Services performed by election officials and election workers paid less than the threshold amount mandated by law. (A state may optionally include the services

of election workers paid less than the threshold amount under a Section 218 Agreement.) See section **Election Workers** below.

- Other services that would be excluded if performed for a private employer because the work is not defined as employment under Section 210(a) of the Social Security Act. (A state may optionally include certain agricultural services under a Section 218 Agreement.)

**Optional Exclusions** - Under a Section 218 Agreement, a state can exclude from coverage the following services performed by members of any coverage group including retirement system coverage groups. **If the Agreement does not specifically exclude these services, they are covered.** Beginning July 2, 1991, most services that were optionally excluded under a Section 218 Agreement are covered by the mandatory provisions unless: 1) the employee is covered under a public retirement system or 2) the services are excluded from mandatory coverage under Section 210 of the Act (e.g., election worker services, student services).

- All services in any class or classes of elective positions.
- All services in any class or classes of part-time positions.
- All services in any class or classes of positions paid on a fee basis.
- Agricultural labor, but only those services that would be excluded if performed for a private sector employer.
- Services performed by students enrolled and regularly attending classes at the school, college or university where they are working.
- Services performed by election officials or election workers paid less than the threshold amount mandated by law. (If the state's Section 218 Agreement does not have an election-worker exclusion or the entity has an Agreement that does not exclude election workers, social security and Medicare taxes apply from the first dollar paid.) See section on **Election Workers** below.

These exclusions can be taken by the state in any combination for each separate coverage group. Any services a state excludes can be included later if permitted by Federal and state law and the state's Agreement. Generally, if one of the types of work listed above has been included in a coverage group, it cannot later be removed from coverage except for services performed by (1) election officials or election workers and (2) solely fee-based positions.

Note: The 1972 Amendments to the Social Security Act allowed states a limited period to exclude services in part-time positions and services performed by students where this exclusion was not taken initially.

Likewise, Section 2023 of Public Law 105-277 enacted October 21, 1998, allowed states a limited period to exclude the services of students employed by the public school, college or university where they are regularly attending classes. In those states exercising this option, the student exclusion was effective July 1, 2000. Where a state utilized either or both of these special one-time provisions for excluding

services that had been covered previously, it cannot again cover these services under a Section 218 Agreement.

## **Election Workers**

The Federal Insurance Contributions Act (FICA) tax exclusion for election workers is \$1,200 for calendar year beginning January 1, 2002, unless those wages are subject to social security and Medicare under the state's Section 218 Agreement. Many states have excluded election workers paid less the threshold amount mandated by law. Therefore, the social security and Medicare taxes do not apply until the election worker is paid \$1,200 or more.

Some state agreements specify a lower threshold amount for election workers, e.g., \$50 a calendar quarter or \$100 a calendar year. In these states, the social security and Medicare tax applies when the amount specified in the state's agreement is met. States may modify the state's agreement to exclude the services of election workers paid less than the threshold amount mandated by law. Such modifications are effective in the calendar year the modification is mailed or delivered to SSA.

If the state's agreement does not have an election worker exclusion or the entity has a Section 218 Agreement that does not exclude election workers, social security and Medicare taxes apply from the first dollar paid. If the entity is not covered under a Section 218 Agreement, the rules for mandatory social security and Medicare under Section 210(a)(7)(F) of the Social Security Act apply.

The election worker threshold amount for calendar years 2000 and 2001 was \$1,100. The threshold amount was \$1,000 for years 1995-1999. For years 1978 through 1994, the threshold amount was \$100 a calendar year. For years 1968 through 1977, the threshold was \$50 a calendar quarter.

Contact the State Social Security Administrator concerning status of election workers under the state's Section 218 Agreement. IRS Revenue Ruling 2000-6 (W-2 Reporting Requirements for Election Workers) provides reporting instructions for election workers. See **Appendix**).

## **Fee-Based Public Officials**

A fee-based public official is one who receives and retains remuneration directly from the public, e.g., a notary public. An individual who receives payment for services from government funds in the form of a wage or salary is not a fee-based public official, even if the compensation is called a fee. See Revenue Ruling 74-608, 1974-2 C.B. 275, stating that fees received by fee-based public officials are subject to SECA tax.

## **Fee-Basis Exclusion—Positions Compensated Solely by Fees**

Services in positions compensated solely by fees are excluded from coverage under Section 218 Agreements (unless the state specifically included these services) and are covered as self-employment and subject to SECA.

## **Fee-Basis Exclusion—Position Compensated by Salary and Fees**

Generally, a position compensated by a salary and fees is considered a fee-basis position if the fees are the principal source of compensation, unless a state law provides that a position for which any salary is paid is not a fee-basis position. A state may exclude services from social security/Medicare coverage under Section 218 Agreements in positions compensated by both salary and fees. If the exclusion is taken, none of the compensation received, including the salary, is covered wages under the state's 218 Agreement. In this case, the salary payment, while excluded under the Agreement, would be subject to mandatory social security if the official is not a qualified participant in a public retirement system.

## **Police Officers and Firefighters**

Police officer and firefighter positions are defined under state statutes and court decisions. The terms do not include services in positions that, although connected with police and firefighting functions, are not actually police officer and firefighter positions.

Note: Police officers and firefighters are not considered emergency workers under the mandatory exclusion from social security and Medicare coverage. This exclusion applies only to services of an employee who was hired because of an unforeseen emergency to do work in connection with that emergency on a temporary basis (e.g., an individual hired to battle a major forest fire or to provide emergency assistance in other similar disasters such as volcano eruption, severe ice storm, earthquake, flood).

Beginning August 16, 1994, all states may extend social security and Medicare or Medicare-only coverage to police officer and firefighter positions covered under a retirement system through a referendum procedure conducted by the state. Prior to that date, only 23 states (and all interstate instrumentalities) were specifically authorized to do so. These states are:

Alabama	Kansas	North Carolina	Tennessee
California	Maine	North Dakota	Texas
Florida	Maryland	Oregon	Vermont
Georgia	Mississippi	Puerto Rico	Virginia
Hawaii	Montana	South Carolina	Washington
Idaho	New York	South Dakota	

All states may use the majority vote referendum procedure. Some states are also authorized under the Act to use the divided retirement system referendum. (Interstate



instrumentalities may use the majority or divided retirement system referendum procedures.)

If the police officers and firefighters are covered under the same retirement system, their positions may be considered separate retirement systems for referendum and coverage purposes, or combined with each other, or with other positions, or both.

### **Police and Firefighter Positions Not Covered Under a Retirement System**

If police officer and firefighter positions are not covered under a retirement system, these positions are mandatorily covered for social security and Medicare unless the positions were already covered under an Agreement as part of a non-retirement system coverage group.

### **Foreign Students, Teachers and Apprentices**

Wages earned within the United States are subject to income tax whether or not the workers are U.S. citizens. Nonresident students who are not U.S. citizens, permanent residents or resident aliens for tax purposes may be able to take advantage of treaty exemptions to exclude a portion of their U.S. source income from withholding. For more information on specific issues, contact the IRS or SSA. (See IRS Publications 515, 519 and 901 for additional information.) These individuals are admitted to the United States under an F-1, J-1, M-1 or Q-1 visa and are generally exempt from both social security and Medicare taxes.

### **Applicability of Federal and State Laws to Coverage Issues**

Federal law governs determinations involving coverage of state and local government employees. These determinations may be based on decisions regarding specific issues to which Federal law is applied and other issues to which state law is applied. It is important to know whether Federal or state law is applied in making a determination on a specific issue. Generally, questions involving interpretation or application of state law are resolved by the authorized legal officers of the state in accordance with applicable state and local laws, regulations and the state court decisions. The chart below shows the more significant issues that will require such determinations and the authority under which the determinations are to be made:

#### **Federal Law:**

Does an employer-employee relationship exist?  
What is the identity of the employer?  
Are earnings wages?  
What are emergency services?  
What are student services?

#### **State Law:**

Who is an officer of a state or political subdivision?  
Is an entity a political subdivision?  
Is a function governmental or proprietary?

Is a position under a retirement system?  
Which employees are eligible for membership in a retirement system?  
Who is an employee for purposes of retirement system participation?

The IRS determines whether earnings are subject to social security and Medicare. SSA decides issues regarding whether to report the earnings as wages. However, state laws have a bearing on the issue of employment, e.g., whether a position is that of a public official of a state. Where this is the case, an opinion of the state legal officer may be requested. The state's opinion will be given weight in making the decision, but it will not be determinative of the issue. Before contacting IRS or SSA, contact the State Social Security Administrator for guidance. (See list of State Administrators in Chapter 7.)

## **Identity of the Employer for Social Security Coverage and Taxation Purposes**

Sometimes it is not clear which of two or more entities, organizations, or individuals is a worker's employer. In some cases, individuals ("leased workers") are supplied or paid by one entity but work under the direction of another. Generally, if there is a provision in a statute or ordinance that creates a position, and the individual is hired or elected under this authority, the individual is an employee of the state or political subdivision to which the provision applies. If there is no such authority, the employer is the entity that has the right to control the worker in the performance of the work, i.e., the common-law employer.

## **State Entities and Reporting Officials**

The employing entity is responsible for withholding and paying social security and Medicare taxes on its employees' wages, as well as reporting to SSA the amount of wages paid. These withholding, paying and reporting requirements apply to wages of individuals subject to mandatory social security and Medicare, as well as to wages of individuals covered under a Section 218 Agreement. (Refer to IRS Publication 15, *Circular E, Employer's Tax Guide*, for more information.)

The reporting officials should be familiar with Form 941 filing requirements, Federal tax deposit requirements, and information return requirements, and they should maintain appropriate records.

The IRS has the responsibility for investigating incorrect reports and failures in reporting and assisting local officials in the proper preparation of tax reports. The SSA Employer Services Liaison Officer has the responsibility for responding to questions regarding the preparation of wage reports. (See Chapter 10, **Public Employer Responsibilities**.)

## **Indian Tribal Governments**

Indian tribal governments, while treated as states for many purposes, are not treated as states for social security and Medicare tax purposes (IRC section 7871). Thus Indian

tribal governments do not enter into Section 218 Agreements with SSA and may not participate in a public retirement system as an alternative to paying social security and Medicare tax under the provisions of IRC section 3121(b)(7)(F). Generally, Indian tribal governments should consult publications generally applicable to non-governmental entities for employment tax rules. Publications 15, *Employer's Tax Guide*, and 15-A, *Employer's Supplemental Tax Guide*, provide the basic rules for employers. There are some special employment tax rules that apply to Indian tribal governments.

First, there is an exception to the definition of *employment* for FUTA purposes for services performed in the employ of an Indian tribe. See IRC section 3306(c)(7). Thus, Federally recognized Indian tribes are not subject to the FUTA tax, unless they so elect. For this purpose, the term *Indian tribe* has the meaning given in 25 USC Section 450b(e) (Section 4(e) of the Indian Self-Determination and Education Assistance Act). Indian tribe includes any subdivision, subsidiary, or business enterprise wholly owned by an Indian tribe. See IRC section 3306(u).

Second, amounts paid to members of Indian tribal councils for services performed as council members are not wages for purposes of FICA and income tax withholding (although such amounts are includible in gross income). Revenue Ruling 1959-354, 1959-2 C.B. 24.

Third, certain income derived by Indians from the exercise of their recognized tribal fishing rights is exempt from Federal income and employment taxes (IRC section 7873). Wages paid to a member of a tribe employed by another member of the same tribe, or by a qualified Indian entity, for services performed in a fishing-rights-related activity of the employee's tribe are exempt not only from Federal income tax, but also from both the employer's and the employee's share of the social security and Medicare tax (Notice 89-34, 1989-1 C.B. 674).

## QUESTIONS AND ANSWERS

- 1. How is prison inmate labor treated?** Generally, services performed by inmates for the state or local political subdivision that operates the prison are excluded from coverage whether or not performed outside the confines of the prison. This is because inmates usually are not in an employment relationship with the state or political subdivision. Services performed by inmates for an entity other than the state or local governmental unit, e.g., a work-release program, may be covered if an employment relationship exists.

SSA determines the employer under the common-law control test in 20 CFR 404.1007. The relevant factor for determining social security coverage is whether an employer/employee relationship exists between the inmate and the non-governmental employer, not the place where the inmate is incarcerated. An employer/employee relationship exists when the entity for which the inmate performs services has the right to control and direct the inmate worker regarding the desired result of the work done and the details and means by which the work is

accomplished. This includes the right to select, dismiss, and control the inmate. Services performed by inmates outside the institution for the same unit of government that operates it are considered performed *in the institution*. In addition, services performed by inmates as part of the rehabilitative and therapeutic program of the institution are not usually performed as employees. [IRS]

2. **Who should public employers contact regarding coverage issues, the State Social Security Administrator, IRS or the SSA?** The State Social Security Administrator should always be a state or political subdivision's first contact. If additional assistance is needed, coverage issues should be addressed to SSA. Tax liability issues should be directed to the IRS. [IRS]
3. **Why may a Section 218 Agreement be necessary and/or appropriate?**
  - To provide social security and Medicare coverage for employees already under a public retirement system. These employees will have both social security/Medicare and public retirement system coverage.
  - To provide social security and Medicare coverage for absolute coverage groups prior to choosing retirement system coverage.
  - To provide coverage for services performed that are excluded from mandatory coverage provisions, but are optional exclusions under Section 218 Agreements, e.g., student services; services of election officials and election workers who earn less than the threshold amount.
  - To increase the threshold amount for services performed by election officials/workers from the amount stipulated in the Agreement to the current threshold amount.
  - To provide Medicare HI-only coverage for employees hired before April 1, 1986, who are qualified participants in a public retirement system and meet the continuing employment exception.

Modifications to Section 218 Agreements are necessary to include additional coverage groups, to cover additional services in a group already covered (e.g., services previously optionally excluded), to cover ineligible, to cover employees changing to the "Yes" group in a divided retirement system, to cover previously terminated groups, to identify additional political subdivisions that join a covered retirement system. [STATE]

4. **A Section 218 Agreement can cover services of employees who are in a retirement system but how does the Social Security Administration define a retirement system for this purpose? Is it the same definition that the Internal Revenue Service uses?** A retirement system for retirement system group coverage under an Agreement is a pension, annuity, retirement or similar fund or system established by a state or political subdivision. The system need not be created by the legislature of the state, nor does it have to be a plan under which the benefits are guaranteed by the state constitution. A retirement system can include a group annuity policy purchased by the state or political subdivision from a private

insurance company. **NOTE:** For a retirement system to be covered under a Section 218 Agreement, it **does not need to meet minimum benefit levels.** Only a retirement system a state or political subdivision is considering as an alternative to mandatory social security has to meet these minimum standards as required by the IRS. See Chapter 6, **Public Retirement Systems.** [IRS/SSA]

5. A utility district's Section 218 Agreement, effective on January 1, 1959, covers the services of all positions for social security and Medicare purposes. The utility district, on July 1, 1994, joins the state's public employee retirement system. Would Section 218 coverage continue? Section 218 coverage continues for all employees because the addition of a retirement system does not alter the coverage under the Section 218 Agreement. [SSA]
6. **A worker in a county's finance office has held that position since February 1983. The worker does not belong to a public retirement system. Also, the county is not covered by a Section 218 Agreement. Must the worker and county pay social security and Medicare taxes?** The worker and the county must pay social security and Medicare taxes for services performed after July 1, 1991. If the worker becomes covered under a public retirement system at a later date, however, neither would pay social security taxes. Medicare taxes would not be payable because the worker was hired before April 1, 1986, and meets the continuing employment exception to Medicare. [IRS]
7. **A candidate was elected to a city council on January 1, 1991. The city's Section 218 Agreement, effective on October 1, 1980, excludes elected officials from Section 218 coverage. The city provides no retirement plan for its employees. Must the city council member and city pay social security and Medicare taxes?** The new council member is not a participant in a public retirement system nor covered for social security under the city's Section 218 Agreement. The new council member and city must pay social security and Medicare taxes for services performed after July 1, 1991, under the mandatory coverage provision. [IRS]
8. **Does a college student employed by a university during the summer months qualify for the student social security and Medicare exception if he/she is not regularly enrolled and attending classes at the university during that time?** If an individual is not enrolled in classes during school breaks of more than five weeks, including summer breaks, the student social security and Medicare exception does not apply (other than during payroll periods of a month or less that fall wholly or partially within the academic term). See Revenue Procedure 98-16, Sections 6.04 and 6.05 for further details. [IRS]

**Note:** Revenue Procedure 98-16, Section 3.05, states, in part, "If a state has exercised its option under Section 218 of the Act to provide for coverage of student services, Section 3121(b)(10) of the Code provides that **those services will not qualify for the Student FICA exception.**" Public Law 105-277 enacted

October 21, 1998, provided for a limited time period for states to modify their existing Section 218 Agreements to exclude from coverage services performed by students. The provision was effective July 1, 2000, for states that exercised the option to take this exclusion. [SSA/STATE]

9. **Are the services of police officers and firefighters considered *emergency services* and therefore excluded from social security and Medicare coverage?** Police officers and firefighters are not considered *emergency workers* under the mandatory exclusion from social security and Medicare coverage. This exclusion applies only to services of an employee who was hired because of an unforeseen emergency to do work in connection with that emergency on a temporary basis (e.g., an individual hired to battle a major forest fire or to provide emergency assistance in other similar disasters such as volcano eruption, severe ice storm, earthquake, flood). Therefore the wages of police officers and firefighters who are regularly employed are subject to social security and Medicare under the normal rules. See Chapter 3, **Determining Worker Status** for information on reimbursement of expenses of volunteer firefighters. [IRS]
10. **Are the services of volunteer firefighters covered for social security and Medicare?** Like police officers and firefighters, the services of volunteer firefighters who work regularly but intermittently are not considered emergency services that would exclude them from coverage. Thus, if the worker is an employee, any compensation he or she receives is wages and subject to social security and Medicare if no mandatory exclusion applies and the work is covered under a Section 218 Agreement or under the mandatory coverage provisions.

Generally, “volunteer” firefighters are employees of the fire department or district for which they perform services. The usual common-law tests apply to determine their employment status; for example, the relationship between the firefighter and the fire department will generally indicate that the department provides training and direction in how the work will be performed and provides the equipment to perform the work.

Payments to these firefighters who are employees under the common-law tests are treated the same as payments to other government employees. There is no rule exempting “de minimis” payments from taxes. Amounts received as reimbursements for expenses are not treated as wages if the reimbursements meet the tests for an accountable plan. See Chapter 3, **Determining Worker Status**. [IRS]

## Chapter 5

# Medicare Coverage

The Centers for Medicare & Medicaid Services (CMS), formerly known as the Health Care Financing Administration (HCFA), administers Medicare, the nation's largest health insurance program. Medicare is a health insurance program for people 65 years of age and older and certain people with disabilities. Medicare has two parts: Part A (Hospital Insurance) and Part B (Medical Insurance). Part A helps pay for inpatient hospital care, skilled nursing care and other services. Part B helps pay for doctor's fees, outpatient hospital visits and other medical services and supplies. Individuals who are entitled to monthly social security benefits are entitled to Part A coverage at age 65, as are individuals who have Medicare-only coverage under a Section 218 Agreement. Others who are not insured for Part A through their own employment may have coverage as the spouse, divorced spouse, or widow(er) of a covered individual. Those who do not have social security or Medicare-only coverage can obtain Part A coverage by paying a monthly premium.

**Example:** A public school teacher, covered by a state teachers retirement system, whose entire public service was performed at the same board of education, may be exempt from both social security and Medicare. This teacher, unless qualifying for HI as a spouse, would have to purchase HI coverage by paying substantial premiums.

Contact the Social Security Administration to determine whether, and when, an application needs to be filed for Part A coverage. Individuals who enroll in Part B pay a monthly premium for the insurance.

## Mandatory Medicare Coverage

State and local government employees hired (or rehired) after March 31, 1986, are subject to mandatory Medicare coverage. Public employees covered under a Section 218 Agreement are already covered under Medicare. Employees whose services are not covered for social security but who are required to pay the Medicare-only portion of FICA are referred to as Medicare Qualified Government Employees (MQGE).

Employees who have been in continuous employment with the employer since March 31, 1986, who are not covered under a Section 218 Agreement nor subject to the mandatory social security and Medicare provisions, remain exempt from both social security and Medicare taxes, provided they are members of a public retirement system. (See section **Continuing Employment Exception**, below.)

The flowchart "Social Security and Medicare Coverage for State and Local Government Employees" in Chapter 1 shows how to determine whether Medicare coverage applies.

## **Continuing Employment Exception**

Services performed after March 31, 1986, by an employee who was hired by a state or political subdivision employer before April 1, 1986, are exempt from mandatory Medicare coverage if the employee is a member of a public retirement system and meets all of the following requirements:

- The employee was performing regular and substantial services for remuneration for the state or political subdivision employer before April 1, 1986
- The employee was a bona fide employee of that employer on March 31, 1986
- The employment relationship with that employer was not entered into for purposes of avoiding the Medicare tax
- The employment relationship with that employer has been continuous since March 31, 1986. (See Revenue Ruling 86-88 and Revenue Ruling 88-36 in the **Appendix**.)

## **Services Not Subject to Mandatory Medicare Coverage**

The following are not subject to mandatory Medicare coverage even though the services are performed by an employee hired after March 31, 1986:

- Services performed by individuals hired to be relieved from unemployment. (This does not include many programs financed from Federal funds where the primary purpose is to give the employee work experience or training.)
- Services performed in a hospital, home or other institution by a patient or inmate thereof as an employee of a state or local government employer.
- Services performed by an employee on a **temporary** basis in case of fire, storm, snow, earthquake, flood or other similar **emergency**.
- Services performed by non-resident aliens with F-1, J-1, M-1 and Q-1 visas.
- Services in positions compensated solely by fees that are subject to SECA, the Self-Employment Contributions Act (unless Section 218 Agreement covers these services).
- Services performed by a student enrolled and regularly attending classes at the school, college or university where they are working (unless Section 218 Agreement covers student services).
- Services performed by an election worker or official whose pay in a calendar year is less than the amount mandated by law (unless Section 218 agreement covers election workers).
- Services that would be excluded if performed for a private employer because it is not work defined as employment under Section 210(a) of the Social Security Act (unless Section 218 Agreement covers certain agricultural services).

See Chapter 4, **Social Security Coverage**, section on Mandatory Exclusions for more details on these exclusions.



## Voluntary Medicare Coverage

A Section 218 Agreement can be executed to provide Medicare-only coverage for employees who are qualified participants in a public retirement system and not covered under a Section 218 Agreement. Contact your State Social Security Administrator for further information. (See list of state administrators in Chapter 7, **State Social Security Administrators**). The same rules discussed in Chapter 4, **Social Security Coverage**, apply.

## QUESTIONS AND ANSWERS

1. **An employee signed an employment contract before April 1, 1986, but did not begin to perform services until after March 31, 1986. Does the employee qualify for the continuing employment exception?** No. The employee does not qualify for the continuing employment exception because the employee was not performing regular and substantial services for remuneration before April 1, 1986. (Revenue Ruling 86-88.) [IRS]
2. **Before April 1, 1986, an individual was performing services for remuneration as a substitute teacher on an as-needed basis for a state entity, and the individual continued performing those services on that basis after March 31, 1986. Does the individual qualify for the continuing employment exception?** No. The individual does not qualify for the continuing employment exception. Even though the services performed may have been substantial, the services were not regular because they were performed on an as-needed basis. (IRC section 3121(u)(2)(c)(ii)(I)) (Revenue Ruling 86-88.) [IRS]
3. **A state employee was performing regular and substantial services for remuneration prior to April 1, 1986. The employee's employment with the state employer was terminated after March 31, 1986, but the employee was later rehired by the state employer. Does the continuing employment exception apply to the employee?** No. The employment must **not** have been terminated in order for the continuing employment exception to apply. [IRS]
4. **How is termination of employment defined for purposes of determining whether the Medicare tax is applicable?** The question of whether an employment relationship has terminated is a question of fact that must be determined on the basis of all the relevant facts and circumstances. Great weight, however, will be given to the personnel rules of the state employer or political subdivision employer to determine whether an employment relationship has been terminated. (Revenue Ruling 86-88.) [IRS]
5. **An employee who was hired before April 1, 1986, by the state transferred after March 31, 1986, to another state agency. The transfer was made without terminating the employee's employment with the state. Does the employee qualify for the continuing employment exception?** Yes. An employee hired before

April 1, 1986, by a state employer and who transfers after March 31, 1986, to another state employer of the same state may qualify for the continuing employment exception, **provided the transfer was made without a termination of the employee's overall employment relationship with that state.** The same rule applies to an employee hired before April 1, 1986, by a political subdivision employer, who transfers after March 31, 1986, to another employer of that same political subdivision.

However, an employee hired before April 1, 1986, does not qualify for the continuing employment exception if after March 31, 1986, the employee transfers from a state employer to a political subdivision employer or from a political subdivision employer to a state employer. Likewise, an employee does not qualify for the exception if the employee transfers from a political subdivision employer in one political subdivision to a political subdivision employer in a different political subdivision, or from a state employer in one state to a state employer in a different state. [IRS]

6. **Can employees who were hired prior to April 1, 1986, and are not currently paying into Medicare, enroll in Medicare in the future?** If an individual's state or local government services are not covered under social security or Medicare, the individual may not be insured (i.e., have enough work credits) for Medicare based on his/her own wages. That individual may be entitled to such coverage based on sufficient *outside* work that is covered for social security or Medicare on his or her own earnings record or that of an insured spouse. Also, state or local public employers can voluntarily choose to cover one or more groups of employees under Medicare-only, even if they are otherwise exempt because of the *continuing employment exception*. The state or local government (through the state) must enter into a modification of the state's Section 218 Agreement to elect such coverage. Contact your State Social Security Administrator for further information. (See Chapter 7 for list of State Administrators). [STATE]
7. **Can employees who were hired prior to April 1, 1986, and who are not currently paying into Medicare, pay into Medicare if they want to?** No. An employee may not make Medicare contributions if the employee's services are not covered under Medicare. However, an employer can provide Medicare HI-only coverage for employees who are members of a retirement system under the Section 218 Agreement through the State Social Security Administrator. [IRS]
8. **A school district is covered by the State Teacher's Retirement System. This school district has never been placed under a Section 218 Agreement. Must a teacher hired by the district on August 1, 1988, pay Medicare?** The teacher must pay the Medicare portion of the FICA taxes because the employee was hired after March 31, 1986. [IRS]
9. **In November 1982, an individual was elected to a state public office for a four-year term, beginning in January 1983, making the individual an employee of the state. In November 1986, the individual was re-elected. Are the individual's services performed in the second term, which began in January**

**1987, subject to the Medicare tax?** No. The continuing employment exception applies here if the employment relationship has not been terminated after March 31, 1986. The individual was re-elected before the first term expired, so there was no break in the employment relationship. Beginning July 2, 1991, the individual would also need to be a member of a public retirement system to qualify for this exception. [IRS]

10. **A professor at a state university, performed regular and substantial services for remuneration for the university from September 1985 to June 1986. The professor was granted a leave of absence for the 1986-87 school year, with the right to return to the same position at the end of the leave. In September 1987, the professor returned from the leave and resumed the same position with the university. Are the professor's services performed after returning from the leave of absence subject to the Medicare tax?** No. The leave of absence was granted by the university and did not terminate the employment relationship. The university's personnel policies indicate that the employment relationship continued because the professor was given the right to return to the same position. (See Q&A-6 of Revenue Ruling 86-88.) Beginning July 2, 1991, the individual must be a member of a public retirement system to qualify for this exception. [IRS]



## Chapter 6

# Public Retirement Systems

With the passage of the 1950 Social Security Amendments, states began to participate in the Social Security program on a “voluntary” basis by entering into Section 218 Agreements with SSA. In 1985, Congress legislated mandatory Medicare for state and local government employees hired or rehired after March 31, 1986.

Effective July 2, 1991, Congress made social security coverage mandatory for state and local government employees who are not covered by a Section 218 Agreement and are not participants in a public retirement system. Under this provision, states can provide these mandatorily covered employees with membership in a public retirement system as an alternative to mandatory social security coverage.

This chapter provides information about the requirements for providing a public retirement system as an alternative to social security.

### **Mandatory Social Security and Public Retirement Systems**

Mandatory social security coverage only applies after an employer determines that 1) the employee’s position is not covered by a Section 218 Agreement and 2) the employee is not a member of a retirement system. If mandatory coverage applies, an employer can provide an alternative to social security as long as it meets the requirements in the IRC Section 3121(b)(7)(F).

This determination is made on an employee-by-employee basis. For example, a Section 218 Agreement may exclude part-time positions. A public retirement system may exclude part-time employees. If an employee excluded from coverage because of work performed in a part-time position as defined under the agreement is also excluded from membership in a public retirement system because of part-time status, that employee is subject to mandatory social security.

Example: A city has a Section 218 Agreement that excludes part-time positions requiring less than 18 hours of work a week. City cafeteria positions require employees to work only 3 hours a day, 15 hours a week. The city’s public retirement system does not allow membership for employees unless they work 25 hours or more per week. The cafeteria workers are subject to mandatory social security.

This chapter explains the alternative of the public retirement system. It explains the meaning of the terms “qualified participant” and “public retirement system,” as they are defined in the IRC section 3121(b)(7)(F) and Section 31.3121(b)(7)-2 of the Employment Tax Regulations. The term “employer” will be used only to refer to a state, political subdivision, or instrumentality. The term “employee” will be used only to refer to an employee of a state, political subdivision, or instrumentality.

## **Public Retirement System**

A *public retirement system* is a pension, annuity, retirement or similar fund or system maintained by a state or local government that provides a retirement benefit to the employee that is comparable to the benefit provided under the Old-Age portion of the Old-Age, Survivors and Disability Insurance (social security) part of FICA. In other words, a retirement system must provide a minimum retirement benefit.

Social security is NOT a public retirement system for this purpose.

Example: An individual holds two positions with the same political subdivision. The wages earned in one position are subject to social security and Medicare tax pursuant to a Section 218 Agreement. The social security system is not a retirement system for this purpose. Thus, mandatory social security coverage applies to service in the other position unless the employee is a member of a public retirement system with respect to that position. Section 31.3121(b)(7)-2(e)(1).

## **Types of Retirement Systems**

In general, there are two types of retirement systems—the **defined contribution plan** and the **defined benefit plan**. A retirement system does not have to be a qualified plan within the meaning of the Employees’ Retirement Income Security Act of 1974 (ERISA). For this reason, this publication does not use the term “qualified” with respect to public retirement systems. The employee may be a member of any type of retirement system, including a non-qualified system (e.g., a section 457 plan), as long as the plan provides a minimum level of benefits under that system. The minimum benefit requirements are contained in the regulations section 31.3121(b)(7)-2(e) and in Revenue Procedure 91-40. (See the Appendix.)

### **Defined Contribution Plan**

A defined contribution plan is a plan that provides an individual account for each participant and provides benefits based solely on the amount contributed to the participant’s account, and any income, expenses, gains or losses, etc. that may be allocated to that participant’s account. See IRC section 414(i).

A defined contribution plan that satisfies the definition of a retirement system must provide for an allocation to the employee’s account of at least 7.5 percent of the employee’s compensation during any period under consideration. This plan could be established under IRC sections 401(a), 403(b) or 457, for example. Contributions from both the employer and the employee may be used to make up the 7.5 percent. Matching contributions by the employer may be taken into account for this purpose. A plan with

only employee contributions would also satisfy the minimum benefit requirement, provided the contributions are at least 7.5 percent of compensation. The 7.5 percent cannot include any earnings on the account, however. To qualify as a retirement system, a defined contribution plan must credit employees' accounts with a reasonable interest rate, or the accounts must be held in a separate trust subject to fiduciary standards and credited with actual earnings. The definition of compensation must at least equal the definition of the employee's base pay.

### **Defined Benefit Plan**

A defined benefit plan is any plan other than a defined contribution plan (IRC section 414(j)). A defined benefit plan determines benefits on the basis of a formula, generally based on age, years of service and salary level.

A defined benefit retirement system provides for a retirement benefit to the employee that is comparable to the benefit provided by the social security part of FICA. Apply the formulas in Revenue Procedure 91-40 and the IRS regulations to determine whether a defined benefit retirement system provides a sufficient benefit. For example, a plan generally meets the requirement if the benefit under the system is at least 1.5 percent of average compensation during an employee's last three years of employment, multiplied by the employee's number of years of service.

### **Definition of Compensation**

For a defined contribution plan, the definition of compensation used to determine whether the benefit is sufficient must include at least the employee's base pay, provided the definition of "base pay" is reasonable. Thus, for example, a defined contribution retirement system may disregard one or more of the following: overtime pay, bonuses, or single-sum amounts received on account of death or separation from service, amounts received under a bona fide vacation, compensatory time or sick pay plan, or amounts received under severance pay plans. Any compensation more than the social security contribution wage base may also be disregarded.

Example: A political subdivision maintains an elective defined contribution plan that is a retirement system within the meaning of IRS regulations. The plan is on a calendar year. In 2001, an employee contributes to the plan at a rate of 7.5 percent of base pay. Assume that the employee will reach the social security maximum contribution base in October. The employee is a qualified participant in the plan for the entire plan year, even if the employee ceases to contribute to the plan after reaching the maximum contribution base. See Section 31.3121(b)(7)-2(e)(2)(iii)(B).

**Reasonable Interest Rate Requirement** – Generally, a defined contribution retirement system must credit the employee's account with earnings at a reasonable rate, under all the facts and circumstances. Alternatively, employees' accounts may be held in a separate trust subject to general fiduciary standards and credited with actual earnings of the trust

fund. Whether the interest rate is reasonable is determined after reducing the rate to adjust for the payment of any administrative expenses.

## **Qualified Participant**

For an employee to be excluded from mandatory social security coverage, not only must the employing entity maintain a retirement system within the meaning of IRC section 3121(b)(7)(F); the employee must also be a qualified participant in that system. An entity may maintain a retirement system in which not every employee is a qualified participant. The definition of a qualified participant for defined contribution and defined benefit systems is similar. Whether an employee is a qualified participant is determined as services are performed.

## **Defined Contribution Retirement System**

An employee is a qualified participant in a defined contribution retirement system with respect to services performed on a given day if, on that day, the employee has satisfied all conditions (other than vesting) for receiving an allocation to his or her account (exclusive of earnings) that meets the minimum retirement benefit requirement. The benefit must be calculated with respect to compensation during a period ending on that day and beginning on or after the beginning of the plan year of the retirement system. This is the case regardless of whether the allocations were made or accrued before the effective date of IRC section 3121(b)(7)(F).

Example 1: A state-owned hospital maintains a nonelective defined contribution plan that is a retirement system within the meaning of IRS regulations. Under the terms of the plan, employees must be employed on the last day of a plan year in order to receive any allocation for the year. Under these facts, employees may not be treated as qualified participants in the plan before the last day of the year. However, if, under the terms of the plan, an employee who terminates service before the end of a plan year receives a pro rata portion of the allocation of the contribution the employee would have received at the end of the year, the employee may be treated as a qualified participant in the plan. In other words, the pro rata allocation available on a given day would have to meet the minimum retirement benefit requirement with respect to compensation from the beginning of the plan year through that day. Section 31.3121(b)(7)-2(d)(1)(ii).

Example 2: A political subdivision maintains an elective defined contribution plan that is a retirement system within the meaning of IRS regulations. The plan is on a calendar year. It has two open seasons—in December and June—when employees can change their contribution elections. In December, an employee elects not to contribute to the plan. In June, the employee elects (beginning July 1) to contribute a uniform percentage of compensation for each pay period to the plan for the remainder



of the plan year. The employee is not a qualified participant in the plan during the period January-June, because no allocations are made to the employee's account during that time, and it is not certain that any allocations will be made. If the level of contributions during the period of July-December meets the minimum retirement benefit requirement with respect to compensation during that period, however, the employee is treated as a qualified participant during that period. On the other hand, assume the same facts, except that the plan allows participants to cancel their elections in cases of economic hardship. In October, the employee suffers an economic hardship and cancels the election (effective November 1). If the contributions during the period July-October are high enough to meet the minimum retirement benefit requirement with respect to compensation during that period, the employee is treated as a qualified participant during that period. In addition, if the contributions during the period July-October are high enough to meet the requirements for the entire period July-December, the employee is treated as a qualified participant in the plan throughout the period July-December, even though no allocations are made to the employee's account in the last two months of the year. There is no requirement that the period used to determine whether an employee is a qualified participant on a given day remains the same from day to day, as long as the period begins on or after the beginning of the plan year and ends on the date the determination is being made. Section 31.3121(b)(7)-2(d)(1)(ii).

### **Defined Benefit Retirement System**

An employee is a qualified participant in a defined benefit retirement system with respect to services performed on a given day if, on that day, the employee is (or ever has been) an actual participant in the retirement system and, on that day, the employee actually has a total accrued benefit that meets the minimum retirement benefit requirement. An employee may not be treated as an actual participant or as actually having an accrued benefit for this purpose to the extent that such participation or benefit is subject to any conditions (other than vesting) that have not been satisfied. The conditions might be a requirement that the employee attain a minimum age, perform a minimum period of service, make an election in order to participate, or be present at the end of the plan year in order to be credited with an accrual.

Example: A political subdivision maintains a defined benefit plan that is a retirement system within the meaning of IRS regulations. Under the terms of the plan, service during a plan year is not credited for accrual purposes unless a participant has at least 1,000 hours of service during the year. Benefits that accrue only upon satisfaction of this 1,000-hour requirement may not be taken into account in determining whether an employee is a qualified participant in the plan before the 1,000-

hour requirement is satisfied. See Section 31.3121(b)(7)-2(d)(1)(i).

## **Part-Time, Seasonal and Temporary Employees**

Special rules apply to part-time, seasonal and temporary employees for purposes of determining whether they are qualified participants in a public retirement system. To be exempt from mandatory social security coverage, these employees must not only be qualified participants; they must be fully vested in their benefits. This means the benefits cannot be forfeited. If a part-time, seasonal or temporary employee is not a qualified participant in a public retirement system with benefits fully vested from the first day of employment, that employee is subject to social security and Medicare tax until the employee becomes fully vested.

The special vesting requirement is considered to be met if a part-time, seasonal or temporary employee in a defined benefit plan has the right to receive a payment of at least 7.5 percent of the compensation the employee earned while covered under the retirement system (plus interest) when the employee separates from employment.

Note: The definition of “part-time” under mandatory social security should not be confused with the definition of “part-time” under Section 218 Agreements. Part-time positions may be excluded from coverage under a Section 218 Agreement, at the option of the state. Contact the State Social Security Administrator to determine the definition of part-time positions under the state’s Section 218 Agreement.

Example: A city provided social security coverage to some of its employees under a Section 218 Agreement, but excluded services performed in part-time positions. Part-time positions are defined by the Section 218 Agreement as positions normally requiring less than 50 hours of service per month. The city must apply the definition in the Section 218 Agreement to determine which employees are excluded from social security coverage under the Agreement. Any employees excluded from coverage under the Agreement may then be subject to mandatory coverage.

### **Part-Time Employee**

A part-time employee, for purposes of mandatory social security and Medicare tax, is any employee who normally works 20 hours or less per week. A teacher employed by a post-secondary educational institution (e.g., a community or junior college, post-secondary vocational school, college, university or graduate school) is not considered part-time if the teacher normally teaches classroom hours of one-half or more of the number of classroom hours normally considered to be full-time employment. See Section 31.3121(b)(7)-2(d)(2)(iii).

Example: A community college treats a teacher as a full-time employee if the teacher is assigned to work 15 classroom hours per week. A new teacher is assigned to work eight classroom hours per week. Because the assigned classroom hours of the teacher are at least one-half of the school's definition of full-time teacher, the teacher is not a part-time employee. See Section 1.3121(b)(7)-2(d)(2)(iii).

### **Seasonal Employee**

A seasonal employee is any employee who normally works on a full-time basis less than five months in a year. Thus, for example, individuals who are hired by a political subdivision during the tax return season in order to process incoming returns and work full-time over a three-month period are seasonal employees. See Section 31.3121(b)(7)-2(d)(2)(iii).

### **Temporary Employee**

A temporary employee is one who performs services under a contractual arrangement that is expected to last two years or less. Under this rule, a teacher under an annual contract may or may not be a temporary employee. Possible contract extensions must be considered in determining the duration of a contractual arrangement if there is a significant likelihood that the employee's contract will be extended. Contract extensions are considered likely to occur if, on average, 80 percent of similarly situated employees have had bona fide offers to renew their contracts in the immediately preceding two academic or calendar years. Contract extensions are also considered significantly likely to occur if the employee has a history of contract extensions in the current position. See Section 31.3121(b)(7)-2(d)(2)(iii)(C).

### **Determining Benefits**

Whether an employee is a part-time, seasonal or temporary employee is generally determined on the basis of service in each position. This determination does not take into account service in other positions with the same or different public employers. However, all of an employee's service in other positions with the same or different employers may be taken into account for purposes of determining whether an employee is a part-time, seasonal or temporary employee with respect to benefits under the retirement system provided that:

- The employee's service in the other positions is or was covered by the same retirement system;
- All service aggregated for purposes of determining whether an employee is a part-time, seasonal or temporary employee (and related compensation) is aggregated under the system for all purposes in determining benefits (including vesting); and
- The employee is treated at least as favorably as a full-time employee under the retirement system for benefit accrual purposes.

Example: Assume that an employee works 15 hours per week for a county and 10 hours per week for a municipality (the

employers) and that both of these employers contribute to the same statewide public employee retirement system. Assume further that the employee's service in both positions is aggregated under the system for all purposes in determining benefits (including vesting). If the employee is covered under the retirement system with respect to both positions and is treated for benefits accrual purposes at least as favorably as full-time employees, then the employee is not considered a part-time employee of either employer. Therefore his benefits are not required to be immediately vested. See Section 31.3121(b)(7)-2(d)(2)(iii)(D).

## **Individuals Employed in More Than One Position**

If an employee is a member of a retirement system with respect to one full-time position, the employee is generally treated as a member of a retirement system with respect to any other position with the same employer. Section 31.3121(b)(7)-2(c)(2).

Example: An individual is employed full-time by a county and is a qualified participant in its retirement plan with regard to that employment. In addition to this full-time employment, the individual is employed part-time in another position with the same county. The part-time position is not covered by the county retirement plan. Nevertheless, because the individual is a qualified participant in the retirement plan with respect to the full-time position, it is not necessary to pay social security tax with respect to the part-time position. The employee would be subject to Medicare tax if hired after March 31, 1986.

Whether an employee is a member of a retirement system is determined on an entity-by-entity rather than a position-by-position basis. If an employee is a member of a retirement system with respect to service the employee performs in a full-time position, the employee is generally treated as a member of a retirement system with respect to all service performed for the same employer in any other positions. Section 31.3121(b)(7)-2(c)(2).

Caution: In some cases, an individual is employed full-time by a state and is a member of its retirement plan, and is also employed part-time by a city located in the state, but does not participate in the city's retirement plan. The services of the individual for the city are not excluded from employment under Section 3121(b)(7), because the determination of whether services constitute employment for such purposes is made separately with respect to each political subdivision for which services are performed. Section 31.3121(b)(7)-(c)(2).

## **Alternative Lookback Rule**

An employee may be treated as a qualified participant in a retirement system throughout a calendar year if he or she was a qualified participant in the system at the end of the calendar year in which the plan year ends. Section 31.3121(b)(7)-(2)(d)(3)(ii). For the first year of participation, an employee who participates in the retirement system may be treated as a qualified participant during the year if and only if it is reasonable to believe that the employee will be a qualified participant on the last day of the plan year.

In general, the rules regarding qualified participants apply to **former participants** who continue to perform services for the employer or who return after a break in service. Thus, for example, a former employee with a deferred benefit under a defined benefit retirement system, who is reemployed by the same employer but does not resume participation in the retirement system, may continue to be a qualified participant in the system after becoming reemployed if the individual's total accrued benefit under the system meets the minimum retirement benefit requirement (taking into account all periods of service, including current service). See Section 31.3121(b)(7)-2(d)(3)(iii). In other words, the individual might have a "cushion" of benefits above the minimum requirement. If this is so, the employer is not required to withhold and pay social security tax, or make additional payments to the retirement system on his behalf. The individual's status as a qualified participant would have to be continually reevaluated, however, for employment of more than a short period.

## **Treatment of Rehired Annuitants**

A former participant in a retirement system who has retired from service or has reached normal retirement age, and who is then rehired, is deemed a qualified participant in the retirement system. The individual does not have to continue to accrue benefits. Also the distribution of benefits may be suspended pending cessation of services. These conditions must be met:

- The person is a former participant in a retirement system maintained by a state, political subdivision or instrumentality thereof, and
- The person previously retired from service with the state, political subdivision or instrumentality, and
- The person is either currently receiving retirement benefits or has reached normal retirement age.

This rule also applies in the case of an employee who has retired from service with one public employer and who is subsequently hired by another employer that maintains the same retirement system. The employee must have been a former participant in the system due to the employee's former employment. Thus, for example, if a teacher who retires from service with a school district that participated in a statewide teachers' retirement system begins to receive benefits from the system, and later becomes a substitute teacher in another school district that participates in the same statewide system, the employee is

treated as a rehired annuitant. In other words, the teacher does not have to accrue additional benefits in the system. See Section 31.3121(b)(7)-2(d)(4)(ii).

## QUESTIONS AND ANSWERS

1. **What is a public retirement system, as defined by the IRS, that can serve as an alternative to mandatory social security?** A public retirement system is a retirement system maintained by a public employer that satisfies the definition in IRC section 3121(b)(7)(F). It can be a pension, annuity, retirement, or similar fund. A section 457 plan is a retirement system for this purpose. Any type of retirement system, including a public retirement system, can be covered under a Section 218 Agreement. [IRS]
2. **What does it mean to be a qualified participant in a retirement system?** A member must actually participate in the system. If an employee is eligible but decides not to participate, that individual will be subject to mandatory social security tax, up to the amount of the social security wage base for the year. An employer is entitled to treat an employee as a qualified participant if he or she was a qualified participant in the retirement system on the last day of the plan year ending in the previous calendar year. [IRS]
3. **What are the benefit levels for a defined benefit (DB) system?** The general rule is that the plan must offer a benefit comparable to the Social Security Primary Insurance Amount. Revenue Procedure 91-40 establishes minimum standards for a defined benefit plan, based on the plan's formula. For example, a retirement system that provides a benefit at age 65 that is equal to 1.5 percent of average compensation for each year of credited service for a consecutive 36-month period would satisfy the test. The final three years can be used instead of the three highest years. Periods greater than three years can be used with a corresponding increase in the 1.5 percent multiplier. Revenue Procedure 91-40 contains a chart that sets forth factors to be used in calculating the minimum benefit for defined benefit plans. If the system caps the amount of income that can be used to calculate retirement benefits at less than the social security and Medicare wage base or base pay, the safe harbor must be adjusted. [IRS]
4. **What are the benefit levels for a defined contribution (DC) system?** A defined contribution system is required to allocate at least 7.5 percent of a worker's annual compensation to the employee's account. The contribution may be made entirely by the employee, entirely by the employer, or by both. It may include a combination of before- or after-tax contributions by the employer and/or the employee. Benefits can be provided through section 457 plans, section 403(b) tax-sheltered annuities or other defined contribution arrangements. [IRS]
5. **How are part-time, seasonal and temporary workers defined to determine whether they are qualified participants in a public retirement system under IRC section 3121(b)(7)(F)?** A part-time employee works 20 hours or less per

week. A seasonal employee can work full-time but less than 5 months a year. A temporary employee performs services under a contractual arrangement of two years or less. In the case of teachers above the high-school level, part-time is defined as less than one-half the classroom hours designated as full-time. Possible contract extensions must be considered in determining the duration of a contractual arrangement if there is a significant likelihood that the employee's contract will be extended. [IRS]

Future contract extensions are considered likely if (1) on average 80 percent of similarly situated employees have had bona fide offers to renew their contracts in the immediately preceding two academic or calendar years, or (2) the contract history of a particular employee indicates that the employee is not a temporary employee. [IRS]

- 6. Are there special vesting rules for part-time, seasonal and temporary workers?** Part-time, seasonal and temporary employees must be immediately and fully vested (100 percent) in any employer-sponsored retirement system. The vesting requirement for a defined contribution plan is met if an employee has a nonforfeitable right to receive a payment equal to 7.5 percent of the compensation the employee earned while participating in the system plus a reasonable rate of interest when the employee separates from service. The regulations state that the Applicable Federal Rate, the rate for long-term Federal debt instruments, is a reasonable interest rate. Involuntary distributions to an employee when the employee terminates do not violate the vesting requirement if the amount does not exceed \$5,000.

These rules for part-time, seasonal and temporary workers apply if they participate in the employer's general retirement plan or in a separate plan for part-time, seasonal and temporary employees. [IRS]

- 7. If a local government participates in a statewide retirement system, is the plan considered "established" by the employer?** Yes. Even though the plan is not maintained by the local government, it is offered through the employer and would qualify. Nevertheless, each local government is a separate employer. [IRS]
- 8. Is there any waiting period in which social security and Medicare taxes do not have to be paid?** Yes. If a full-time employee can be enrolled in the plan by the first day of the second calendar month of service, social security and Medicare taxes do not have to be paid during this interim period. This rule does not apply to part-time, seasonal and temporary employees. [IRS]
- 9. Is a retirement system that does not cover all employees a "retirement system" within the meaning of Regulations section 31.3121(b)7-2?** This determination is made on an individual-by-individual basis. Thus, a pension plan that is a retirement system for some employees may not be a retirement system for other employees. [IRS]

10. **A teacher who is a participant in a retirement system during the academic year also works a few hours per week in the summer in the school library. The library job is not covered by a Section 218 Agreement or by the public retirement system because it does not fall during the normal 10-month school year. Are the wages for the summer job subject to social security and Medicare taxes?** The wages are not subject to social security taxes because the teacher is a qualified participant in the public retirement system with respect to her full-time job. A teacher who is expected to be employed on a continuing basis qualifies for treatment as employed simultaneously in multiple positions with the same entity. Consequently, the determination may be made solely by reference to service in the teacher's full-time position. The applicability of the Medicare tax depends upon whether the continuing employment exception is available. [IRS]
11. **A teacher retires from a school district, starts collecting a pension under the state retirement system, and returns to work for the same school district as a bus driver. The bus driving position is not covered by a 218 agreement and is not covered by the state retirement system. Does the employee have to pay social security taxes on the wages as a bus driver?** No. The teacher is a rehired annuitant. He is deemed to be a qualified participant in the retirement system without regard to whether he continues to accrue a benefit. He would, however, have to pay Medicare tax because the original employment relationship terminated at retirement. [IRS]



## Chapter 7

# State Social Security Administrators

### What is a State Social Security Administrator?

Each state designates, in statute, a state official to act for the state in negotiations with the SSA. This official acts for the state with respect to the initial Federal-state (Section 218) Agreement, modifications, the performance of the state's responsibilities under the agreement, and in all state dealings concerning the administration of the Agreement. Each state's Section 218 Agreement and Social Security Regulations 404.1204 provide a legal obligation for each state to designate such an official. In many states, however, the actual day-to-day responsibilities are delegated to the staff of the designated state official.

The state is responsible for notifying SSA of any changes regarding the designated state officials. A letter should be sent to the SSA Regional and Parallel Social Security Offices for that state.

For Section 218 Agreement purposes, the responsibilities of the state are to:

- Administer and maintain the Federal-state Section 218 Agreement (“Agreement”) that governs voluntary social security and Medicare coverage by state and local government employers in the state;
- Negotiate modifications to the original Agreement to include additional coverage groups, correct errors in modifications, conduct referenda and identify additional political subdivisions which join a covered retirement system;
- Maintain in a secured location the state's master Agreements, modifications, dissolutions and intrastate agreements;
- Provide SSA with notice and evidence of the legal dissolution of covered state or political subdivision entities;
- Resolve coverage and taxation questions related to the Agreement and modifications with SSA and IRS;
- Negotiate with SSA to resolve social security contribution payment and wage reporting questions concerning wages paid before 1987;
- Provide information to state and local public employers covered under Agreements in accordance with the Act; and

- Provide information to state and local public employers in accordance with the state's enabling legislation, policies, procedures and standards regarding non-section 218 entities. Interaction with non-section 218 entities is appropriate and necessary, but the degree of involvement varies from state to state.

The State Social Security Administrator is the principal state official responsible for these functions. As such, the Administrator serves as the main resource to state and local employers for information and advice about social security coverage, taxation and reporting issues that could not be easily obtained elsewhere. SSA, IRS, public employers and employees should contact the designated Administrator to help resolve questions as to who is and is not covered.

The State Social Security Administrator and staff possess a wealth of knowledge regarding state law, Federal law and regulations, retirement system rules, personnel rules, and how all these interrelate to provide social security protection to public employees. The law requires that each state provide a central point of contact to handle these complex matters.

## **National Conference of State Social Security Administrators (NCSSSA)**

The ever-changing and complex social security coverage statutes, withholding requirements, reporting obligations and associated employment tax regulations require constant monitoring and interpretation. For over 50 years the National Conference of State Social Security Administrators (NCSSSA) has provided an effective network of communication for Federal, state, and local governments concerning social security coverage and Federal employment tax policy.

With the enactment of Section 218 to the Act in 1950, states could first exercise the option of providing social security coverage for state and local employees. By the end of 1951, 30 states had executed Section 218 Agreements with the Federal government. The responsibility for administering the social security program varied from state to state, depending on the particular state's enabling legislation.

State Administrators began to operate in an area where no precedent existed. It became apparent that a forum was needed where the administrators could address the many problems and questions posed by the new program. The first forum between State Social Security Administrators and Federal officials was held in January 1952, in Bloomington, Indiana. As a result, the NCSSSA was established to provide a unified state perspective at the Federal level to provide an on-going medium for problem solving and to maintain an open forum for the development of new policy.

Since its formation in 1952, the NCSSSA has worked closely with SSA and IRS to address social security (and later Medicare) coverage and employment tax issues raised by state and local employers and State Social Security Administrators throughout the United States. The NCSSSA works with the Federal officials to ensure that legislative and regulatory changes address state and local concerns. The NCSSSA provides leadership to state and local governments through accurate interpretation of Federal laws and regulations, communication of Federal tax policy, and resolution of problems arising at the state and local level. The NCSSSA hosts national workshops and annual meetings where SSA and IRS officials address the concerns of state and local government representatives in a face-to-face format. NCSSSA officials represent public sector employers on various SSA and IRS committees and work groups.

For further information about the NCSSSA, contact your State Social Security Administrator. (See the list below. Also, visit NCSSSA's web site at [www.ncsssa.org](http://www.ncsssa.org).)

## **Audits and Reviews of Public Employers**

When the IRS or SSA conducts an audit or review of a public employer, it may contact the State Social Security Administrator for that state to clarify the employer's status, including:

- ✓ Whether the employees are covered under a Section 218 Agreement, and;
- ✓ If so, the specific exclusions (mandatory **and** optional) that are applicable to that entity, which must be taken into account during the audit or review, including any that are unique to individual employees. For example, are any employees subject to the Medicare continuing employment exemption?

**STATE SOCIAL SECURITY ADMINISTRATORS**

<p><b>Alabama</b>          State Social Security Administrator          Office of the State Comptroller          P.O. Box 302602          Montgomery, AL 36130-2602          (334) 242-7186 • FAX (334) 242-3905  <a href="mailto:sblanton@comptroller.state.al.us">sblanton@comptroller.state.al.us</a></p>	<p><b>Colorado</b>          State Social Security Administrator          Colorado Dept. of Labor &amp; Employment          1515 Arapahoe Street, Tower 2, Suite 650          Denver, CO 80202-2117          (303) 318-8061 • FAX (303) 318-8069  <a href="mailto:maryann.motza@state.co.us">maryann.motza@state.co.us</a></p>
<p><b>Alaska</b>          State Social Security Administrator          Division of Retirement &amp; Benefits          P.O. Box 110203          Juneau, AK 99811-0203          (907) 465-4470 • FAX (907) 465-3086  <a href="mailto:Kay_Guyton@admin.state.ak.us">Kay_Guyton@admin.state.ak.us</a></p>	<p><b>Connecticut</b>          State Social Security Administrator          Office of the State Comptroller          Retirement Division          55 Elm Street          Hartford, CT 06106-1775          (860) 702-3524 • FAX (860) 702-3489  <a href="mailto:jeff.bieber@po.state.ct.us">jeff.bieber@po.state.ct.us</a></p>
<p><b>Arizona</b>          State Social Security Administrator          Arizona State Retirement System          P.O. Box 33910          Phoenix, AZ 85067-3910          (602) 240-2022 • FAX (602) 264-6113  <a href="mailto:susanned@asrs.state.az.us">susanned@asrs.state.az.us</a></p>	<p><b>Delaware</b>          State Social Security Administrator          Office of Pensions          540 S. Dupont Highway, Suite 1          Dover, DE 19901-4516          (302) 739-4208, ext 231          FAX (302) 739-6129  <a href="mailto:cwilliams@state.de.us">cwilliams@state.de.us</a></p>
<p><b>Arkansas</b>          State Social Security Administrator          Public Employees' Retirement System          One Union National Plaza          124 W. Capitol          Little Rock, AR 72201-1015          (501) 682-7856 • FAX (501) 682-7825  <a href="mailto:Ardary.Taylor@mail.state.ar.us">Ardary.Taylor@mail.state.ar.us</a></p>	<p><b>Florida</b>          State Social Security Administrator          Division of Retirement          Cedars Executive Center, Building C          2639 N. Monroe Street          Tallahassee, FL 32399-1560          (850) 414-6371 • FAX (850) 410-2019  <a href="mailto:snuggs_s@frs.state.fl.us">snuggs_s@frs.state.fl.us</a></p>
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<p><b>Ohio</b>  State Social Security Administrator  Department of Admin. Services  30 E. Broad Street, 28<sup>th</sup> Floor  Columbus, OH 43266-0405  (614) 387-1869 • FAX (614) 232-1605  <a href="mailto:david.Breckenridge@das.state.oh.us">david.Breckenridge@das.state.oh.us</a></p>	<p><b>South Carolina</b>  State Social Security Administrator  South Carolina Retirement Systems  P.O. Box 11960, Capitol Station  Columbia, SC 29211-1960  (803) 737-6894 • FAX (803) 737-6947  <a href="mailto:fwallace@scrs.state.sc.us">fwallace@scrs.state.sc.us</a></p>
<p><b>Oklahoma</b>  State Social Security Administrator  Department of Human Services  P.O. Box 25352  Oklahoma City, OK 73125-0352  (405) 521-3818 • FAX (405) 522-3181  <a href="mailto:Russell.graves@okdhs.org">Russell.graves@okdhs.org</a></p>	<p><b>South Dakota</b>  State Social Security Administrator  Office of the State Auditor  500 E. Capitol Avenue  Pierre, SD 57501-5070  (605) 773-3325 • FAX (605) 773-5929  <a href="mailto:dougp@osa.state.sd.us">dougp@osa.state.sd.us</a></p>
<p><b>Oregon</b>  State Social Security Administrator  Public Employees' Retirement System  P.O. Box 23700  Tigard, OR 97281-3700  (503) 603-7694 • FAX (503) 598-1218  <a href="mailto:steve.j.delaney@state.or.us">steve.j.delaney@state.or.us</a></p>	<p><b>Tennessee</b>  State Social Security Administrator  Tennessee Consolidated Retirement System  Andrew Jackson State Office Bldg. 10<sup>th</sup> flr.  Nashville, TN 37243-0237  (615) 741-7902 • FAX (615) 532-8725  <a href="mailto:Mary.E.Smith@state.tn.us">Mary.E.Smith@state.tn.us</a></p>
<p><b>Pennsylvania</b>  State Social Security Administrator  Department of Labor and Industry  Labor &amp; Industry Bldg, Room 715  Harrisburg, PA 17120-0019  (717) 783-8860 • FAX (717) 787-4716  <a href="mailto:sspe@state.pa.us">sspe@state.pa.us</a></p>	<p><b>Texas</b>  State Social Security Administrator  Social Security Program  Employees' Retirement System of Texas  P.O. Box 13207  Austin, TX 78711-3207  (512) 867-7373 • FAX (512) 867-7402  <a href="mailto:cfry@ers.state.tx.us">cfry@ers.state.tx.us</a></p>
<p><b>Puerto Rico</b>  State Social Security Administrator  Department of the Treasury  Box 9024 140  San Juan, PR 00902-4140  (787) 723-3585 • FAX (787) 723-6215  <a href="mailto:jsolivan@hacienda.gobierno.pr">jsolivan@hacienda.gobierno.pr</a></p>	<p><b>Utah</b>  State Social Security Administrator  Department of Finance  Room 2110 - State Office Bldg.  Salt Lake City, UT 84114  (801) 538-3024 • FAX (801) 538-3244  <a href="mailto:ajohnston@utah.gov">ajohnston@utah.gov</a></p>
<p><b>Rhode Island</b>  State Social Security Administrator  Office of the General Treasurer  40 Fountain Street  Providence, RI 02903-1844  (401) 222-2502 • FAX (401) 222-2212  <a href="mailto:mariad@treasury.state.ri.us">mariad@treasury.state.ri.us</a></p>	<p><b>Vermont</b>  State Social Security Administrator  Office of the State Treasurer  133 State Street  Montpelier, VT 05633-6901  (802) 828-2305 • FAX (802) 828-5182  <a href="mailto:cwebster@tre.state.vt.us">cwebster@tre.state.vt.us</a></p>

<p><b>Virgin Islands</b>  State Social Security Administrator  Department of Finance  2314 Kronprindsens Gade  Charlotte Amalie, VI 00802  (340) 774-2143 ext2252 • FAX (340) 776-4028  <a href="mailto:Wbelardo@usvi.org">Wbelardo@usvi.org</a></p>	<p><b>West Virginia</b>  State Social Security Administrator  State Auditor's Office  West Wing 100, State Capitol Bldg.  Charleston, WV 25305-0002  (304) 558-2250 Ext. 210 • FAX (304) 558-4155  <a href="mailto:Robinr@wvauditor.com">Robinr@wvauditor.com</a></p>
<p><b>Virginia</b>  State Social Security Administrator  Virginia Retirement System  P.O. Box 2500  Richmond, VA 23218-2500  (804) 344-3128 • FAX (804) 786-1425  <a href="mailto:bfaison@vrs.state.va.us">bfaison@vrs.state.va.us</a></p>	<p><b>Wisconsin</b>  State Social Security Administrator  Department of Employee Trust Funds  P.O. Box 7931  Madison, WI 53707-7931  (608) 266-0728 • FAX (608) 266-5801  <a href="mailto:dale.ferron@etf.state.wi.us">dale.ferron@etf.state.wi.us</a></p>
<p><b>Washington</b>  State Social Security Administrator  Employment Security Department  P.O. Box 9046  Olympia, WA 98507-9046  (360) 902-9222 • FAX (360) 902-9556  <a href="mailto:wgodwin@esd.wa.gov">wgodwin@esd.wa.gov</a></p>	<p><b>Wyoming</b>  State Social Security Administrator  Wyoming Retirement System  1<sup>st</sup> Floor - East Herschler Bldg.  Cheyenne, WY 82002-0001  (307) 777-6109 • FAX (307) 777-5995  <a href="mailto:hwales@state.wy.us">hwales@state.wy.us</a></p>



## QUESTIONS AND ANSWERS

- 1. What is the responsibility of State Social Security Administrators to Section 218 entities?** The State Social Security Administrator has legal responsibilities to entities covered by a Section 218 Agreement as governed by Section 218 of the Social Security Act and Social Security regulations 404.1204. These responsibilities encompass the duties associated with administering and maintaining the Section 218 Federal-state Agreement and the modifications to that agreement. [STATE]
- 2. What is the responsibility of State Social Security Administrators with respect to non-Section 218 entities?** Under Section 218 of the Act, the primary legal responsibility State Social Security Administrators have is for Section 218 entities. However, responsibilities for non-Section 218 entities vary from state to state. Some state administrators may not interact with non-Section 218 entities while others may perform monitoring, quasi-regulatory and enforcement functions. If a non-Section 218 entity needs information regarding coverage under an agreement, it should contact the State Social Security Administrator. [STATE]
- 3. What information can IRS provide to State Social Security Administrators to help them perform their responsibilities especially when an audit or review is to be conducted of a public employer in his/her state?** Section 6103 of the IRC governs the disclosure of tax information by the IRS to other Federal and state agencies. Without the consent of the taxpayer, no provision in section 6103 would authorize the IRS to share specific taxpayer information with State Social Security Administrators. However, in performing a tax investigation, the IRS may request information from the State Social Security Administrator. [IRS]
- 4. What information can be provided by SSA to State Social Security Administrators to help them perform their responsibilities?** SSA may provide interpretations of the Social Security Act, Social Security regulations, rulings, the state Section 218 Agreement and its modifications, as they apply to the public employer at issue. [SSA]
- 5. Where can I obtain a list of governmental employers in my state?** A list of all states and the total number of government employers can be found on the U.S. Bureau of the Census Governments Integrated Directory web site at [www.census.gov](http://www.census.gov). To identify the specific entities, locate a list of state departments in your state and identify who works with employers. You may start with offices such as the state Department of Labor and Employment or Secretary of State and contact other offices such as the Department of Local Affairs. Determine whether any government types are not included in your existing lists and gather lists from the appropriate source(s), such as school districts. [STATE]

## **Chapter 8**

# **Social Security Administration**

### **Overview**

The Social Security Administration (SSA) is the Nation's primary income security Agency. It administers the Federal Old-Age, Survivors and Disability Insurance (OASDI) program and the Supplemental Security Income (SSI) program. The OASDI program is the largest income-maintenance program in the United States. The program provides monthly benefits designed to replace, in part, the loss of income due to retirement, disability or death. The SSI program provides or supplements the income of aged, blind or disabled individuals with limited income and resources. Children, as well as adults, can receive payments because of disability or blindness.

In addition to the OASDI and SSI programs, SSA provides service delivery support to other programs, particularly Medicare, Black Lung, Railroad Retirement, Medicaid and Food Stamps.

### **Medicare**

SSA is the primary public contact point for the Centers for Medicare & Medicaid Services (CMS), which is responsible for administering the Medicare program. SSA staff determines, and answers questions regarding, Medicare eligibility. SSA also maintains records of Medicare eligibility and collects Medicare Part B premiums through withholding from social security payments. (See Chapter 5, **Medicare Coverage**, for more information.)

### **Black Lung**

The Black Lung program pays monthly cash benefits to coal mine workers and their dependents and survivors. SSA is responsible for administering Part B of the Black Lung program under title IV of the Federal Coal Mine Health and Safety Act.

### **Railroad Retirement**

SSA provides services in connection with entitlement to benefits from the Railroad Retirement Board (RRB). SSA takes the applications, determines jurisdiction and coordinates benefit payments with the RRB. The latter organization, as required by statute, issues a combined monthly benefit payment when a retiree is entitled to both Railroad and social security retirement benefits due to having worked for both the railroad and other industries prior to retirement.

## **Medicaid**

In 32 states and the District of Columbia, eligibility for SSI benefits confers automatic entitlement to Medicaid. SSA provides information and referral services in support of Medicaid and is directly funded by the states and CMS.

## **Food Stamps**

SSA assists the Department of Agriculture by providing information about the food stamp program and taking food stamp applications for qualified OASI, DI and SSI claimants.

## **Social Security Number**

The Social Security Number (SSN) is the method used for posting and maintaining the earnings and employment records of persons covered under the social security program. Employers withhold social security and Medicare taxes from their employees' paychecks and forward these amounts, along with an equal amount of employer tax, to the IRS on a regular schedule. By the end of February, employers file wage reports with the SSA showing the wages paid to each employee during the preceding year. In turn, SSA shares this information with the IRS. SSA also sends weekly updates to IRS with information on newly established SSN records and corrected information for previously established SSN records. Reported earnings are posted to the worker's earnings record. When a worker or a worker's family member applies for social security benefits, the worker's earning record is used to determine the eligibility for benefits and the amount of any cash benefits payable. It is thus critical that employers maintain accurate, up-to-date SSN information on their employees to make sure each employee's earnings are correctly posted to that employee's earnings record.

## **Organization**

SSA's organization features centralized management of the national social security programs and a decentralized nationwide network of 10 regional offices overseeing 1,337 field offices (FO), 138 hearing offices, 36 teleservice centers, 7 processing centers and 1 data operations center.

All components within SSA's central office, which is located in Baltimore, Maryland, perform a supporting role to SSA FOs by providing direction, guidance and material resources needed by the FOs. FOs are located in cities and rural communities across the nation and are the agency's main physical point of contact with beneficiaries and the public. Additionally, the social security disability program depends on the work of 54

Disability Determination Services, which include all 50 states, the District of Columbia, Guam and Puerto Rico.

## **SSA Responsibilities**

Public employers should initially discuss issues and questions with the State Social Security Administrator. If additional assistance is needed regarding coverage, the appropriate Parallel Social Security Office should be contacted. (See list at the end of this chapter.) Public employers who have questions regarding magnetic media or electronic filing should contact the appropriate Employer Services Liaison Officer (ESLO) listed in Chapter 10.

For additional contact information, see the SSA web site at [www.ssa.gov/slge](http://www.ssa.gov/slge). Questions related to tax liability should be directed to the IRS.

### **Parallel Social Security Office (PSSO)**

The PSSO, usually located in the state capital, is the on-site representative of the SSA to the state under the leadership of the Regional Commissioner. Its principal responsibilities are to:

- Conduct day-to-day negotiations with the state;
- Assist the state in drafting Section 218 Agreements and modifications;
- Review agreements and modifications from the state for technical accuracy and appropriate documentation before forwarding to the Regional Office; and
- Make coverage and wage determinations, where appropriate.

### **Regional Office (RO)**

RO staff works under the direction of the Regional Commissioner (RC). The RO provides leadership and technical direction in the coverage area for the state and local program within the region, consistent with established policy. Within the RO structure is the Assistant Regional Commissioner (ARC) who has ongoing responsibility for state and local coverage activities within the region. The Regional Office:

- Interprets, reviews, processes and executes Section 218 Agreements and modifications;
- Reviews supporting documentation to state notices to remove legally dissolved entities from coverage under Section 218 Agreements;
- Makes and reviews coverage and wage determinations consistent with established policy;
- Provides guidance and advice to states on proposed legislation and regulations that may have impact on the state's Section 218 Agreement;
- Interprets and advises states on established policies and procedures;
- Refers to Central Office questions for which no policy has been established or present policy may require a change that may have national impact;
- Maintains file of original agreements and modifications;

- Maintains the Summaries of State Agreements; and
- Handles inquiries and answers questions about magnetic media reporting, electronic filing, and paper reporting of wages.

**Note:** Listings of the Regional Social Security Offices and the Parallel Social Security Offices (discussed above) are located at the end of this chapter.

### **Central Office**

The Office of Program Benefits (OPB) is primarily responsible for administering the state and local coverage program. Organizationally, OPB is located under the Deputy Commissioner for Disability and Income Security Programs.

### **Office of Program Benefits (OPB)**

This office plans, develops, evaluates, and issues operational policies and procedures concerning coverage and wage questions related to Sections 210 and 218 of the Social Security Act. As lead component for all state and local matters, OPB administers the Social Security Act and interprets its provisions. OPB:

- Interprets laws and regulations relating to state and local coverage and wages;
- Coordinates national coverage and wage policy with the Internal Revenue Service and other Federal and state agencies;
- Coordinates coverage and wages issues for which no policy has been established or present policy may require a change that may have national impact;
- Issues policies and develops procedures and instructions on coverage, wages, and reporting;
- Administers the policy for decisions involving pre-1987 reporting and wage corrections;
- Maintains and updates the State and Local Coverage Handbook (SLCH) for SSA and the State Social Security Administrators; and
- Makes decisions regarding 218(s) and (t) cases for pre-1987 periods.

### **Office of Communications (OCOMM)**

This office maintains liaison with all levels of government—Federal, state and local (county and municipal). OCOMM has oversight responsibility for both the Agency’s interaction and relationships with government entities with a focus on public information and public affairs. Basically, in regard to state and local activities, OCOMM:

- Coordinates the broad informational effort to explain social security programs to state and local employees and employers;
- Produces comprehensive publicity materials to explain the protection which social security coverage provides;
- Maintains contact with national organizations representing governmental and government employee interest;

- Represents SSA in negotiations with Federal, state and local government agencies on major program issues in regard to public affairs and public information, i.e., the interface between Federal and state income maintenance programs, or implications for state and local governments of proposed changes in SSA administered programs;
- Seeks to insure that the interests of state and local governments and other Federal agencies are represented in SSA's policy and decision making process; and
- Has lead role in NCSSSA/SSA Government Communications Workgroup to develop strategy for reaching state and local audiences as well as to improve communications in general among the states, regions, and Central Office as well as other Federal agencies in state and local matters.

### **Office of Central Operations (OCO)**

This office processes all wage and correction reports and reconciles Annual Wage Reports with IRS Form 941 tax returns and corresponds with employers showing discrepancies.

Specific areas of responsibility for state and local Section 218 employers, for pre-1987 periods, include:

- Receiving, controlling and accounting for contributions including interest;
- Preparing, maintaining and furnishing trust fund reconciliation information;
- Preparing and issuing audit statements on wage reports and corrections; and
- Providing information on outstanding overpayments and underpayments to states and referring outstanding debts to the Office of Financial Policy and Operations (OFPO).

### **Office of Legislation and Congressional Affairs (OLCA)**

Areas of responsibility include:

- Conducting program evaluation and legislative planning activities including those related to state and local coverage issues;
- Monitoring legislation that affects SSA programs and reviewing regulations resulting from legislation;
- Preparing testimony and background material for use by SSA officials in connection with congressional hearings and other contacts with the Congress.

### **Office of Systems Analysis (OSA)**

Areas of responsibility for **pre-1987** tax years include:

- Trust fund accounting of state and local contributions;
- Deposit procedures, including wire transmission of deposits;
- State and local internal adjustments; and

- Audits of state and local reports.

### **Office of Financial Policy and Operations**

- Resolving unpaid Section 218 pre-1987 contribution liability.

## **QUESTIONS AND ANSWERS**

1. **Where should questions that begin “Do we have to pay social security taxes on....” be directed?** Questions related to tax liability should be directed to IRS. [IRS]
2. **What information does SSA provide to State Social Security Administrators to help them perform their responsibilities?** SSA provides interpretations of the Social Security Act, Social Security regulations and rulings, the State Agreement and its modifications, as they apply to the public employer. [SSA]
3. **Whom should I call when I have questions about Annual Wage Reporting?** Call your local Employer Services Liaison Officer. See Chapter 10, or visit the SSA web site at [www.ssa.gov/employer/empcontacts](http://www.ssa.gov/employer/empcontacts). [SSA]

## Regional Social Security Offices

Direct inquiries regarding state and local coverage questions only to State and Local Coverage Specialist. For all other inquiries, go to [www.ssa.gov/reach](http://www.ssa.gov/reach).

### **Boston:**

Social Security Administration  
Room 1900  
JFK Federal Building  
Boston, Massachusetts 02203  
Regina Bachini  
(617) 565-2882  
Regina.Bachini@ssa.gov

### **New York:**

Social Security Administration  
Federal Building, Suite 4060  
26 Federal Plaza  
New York, New York 10278  
Renee Downes-Higginson  
(212) 264-1752  
Renee.Downes-Higginson@ssa.gov

### **Philadelphia:**

Social Security Administration  
P.O. Box 8788  
300 Spring Garden St.  
Philadelphia, Pennsylvania 19101  
Bill Rivers  
(215) 597-1759  
Bill.Rivers@ssa.gov

### **Atlanta:**

Social Security Administration  
61 Forsyth Street, Suite 22T64  
Atlanta, Georgia 30323  
Cathy Palmer  
(404) 562-1324  
Cathy.Palmer@ssa.gov

### **Chicago:**

Social Security Administration  
600 West Madison Street  
10<sup>th</sup> Floor, Chicago, IL 60601  
Darryl Swain  
(312) 575-4239  
Darryl.Swain@ssa.gov

### **Dallas:**

Social Security Administration  
1301 Young St. Ste. 130  
Dallas, Texas 75202-5433  
Susan Mariano  
(214) 767-4272  
Susan.Mariano@ssa.gov

### **Kansas City:**

Social Security Administration  
601 East 12<sup>th</sup> Street, Room 436  
Kansas City, Missouri 64106  
Mary Wilcox  
(816) 936-5657  
Mary.Wilcox@ssa.gov

### **Denver:**

Social Security Administration  
1961 Stout Street  
Room 325 Federal Office Bldg.  
Denver, Colorado 80294-3538  
Phyllis Henderson  
(303) 844-4268  
Phyllis.Henderson@ssa.gov

### **San Francisco:**

Social Security Administration  
P.O. Box 4206  
Richmond, California 94804  
Alan Follett  
(510) 970-8245  
Alan.Follett@ssa.gov

### **Seattle:**

Social Security Administration  
701 Fifth Avenue  
Suite 2900 M/S 303A  
Seattle, Washington 98104-7075  
Tim Beard  
(206) 615-2125  
Tim.Beard@ssa.gov



## Parallel Social Security Office Contacts

<p><b>Region 1</b></p>	<p><b>Connecticut</b> One Corp Center 20 Church Street Suite 900 Hartford, CT 06103</p> <p><b>New Hampshire</b> Suite 100 70 Commercial Street Concord, NH 03301</p>	<p><b>Maine</b> Federal Building 40 Western Avenue, Rm G-26 Augusta, ME 04330</p> <p><b>Rhode Island</b> 380 Westminister Mall Room 318 Providence, RI 02903</p>	<p><b>Massachusetts</b> 1<sup>st</sup> floor 10 Causeway St, Rm 148 Boston, MA 02222</p> <p><b>Vermont</b> 33 School St Montpelier, VT 05602</p>
<p><b>Region 2</b></p>	<p><b>New Jersey</b> Capitol Center Building 50 East State Street, Suite 228 Trenton, NJ 08608</p> <p><b>St. Thomas, Virgin Isles</b> 8000 Nisky Center, 1<sup>st</sup> Flr., Suite 2 Charlotte Amalie, VI 00802-9911</p>	<p><b>New York</b> Federal Building 1 Clinton Ave, Rm 430 Albany, NY 12207</p>	<p><b>Puerto Rico</b> State Road 838, Km 6.3 Sector El Cinco, Piso 4 Rio Piedras, PR 00926</p>
<p><b>Region 3</b></p>	<p><b>Delaware</b> Federal Building 300 S New Street Dover, DE 19904</p> <p><b>Virginia</b> 718 E Franklin Street Richmond, VA 23219</p>	<p><b>Maryland</b> Suite 200, Room 1003 1010 Park Avenue Baltimore, MD 21202</p> <p><b>West Virginia</b> Suite 300 500 Quarrier Street Charleston, WV 25301</p>	<p><b>Pennsylvania</b> 555 Walnut Street Harrisburg, PA 17101</p>
<p><b>Region 4</b></p>	<p><b>Alabama</b> 2450 President Drive Montgomery, AL 36120</p> <p><b>Kentucky</b> 330 W Broadway, 2<sup>nd</sup> Floor Frankfort, KY 40601</p> <p><b>South Carolina</b> Strom Thurmond Federal Building 1835 Assembly St, 2<sup>nd</sup> Floor Columbia, SC 29202</p>	<p><b>Florida</b> 227 N Bronough, Suite 2070 Tallahassee, FL 32301</p> <p><b>Mississippi</b> 100 W Capitol Street, Room 401, McCoy Federal Building Jackson, MS 39269</p> <p><b>Tennessee</b> 4527 Nolensville Road Nashville, TN 37211</p>	<p><b>Georgia</b> 55 Marietta Street, 4<sup>th</sup> floor Atlanta, GA 30303</p> <p><b>North Carolina</b> 4405 Bland Road Raleigh, NC 27609</p>

<b>Region 5</b>	<p><b>Illinois</b> 2 715 West Monroe St Springfield, IL 62704</p> <p><b>Minnesota</b> Federal Building 316 Robert St, Room 185 St. Paul, MN 55101</p>	<p><b>Indiana</b> 5 75 N Pennsylvania St, Room 685 Indianapolis, IN 46204</p> <p><b>Ohio</b> Federal Building 200 North High Street, Room 225 Columbus, OH 43215</p>	<p><b>Michigan</b> 5015 South Cedar, Suite 150 Lansing, MI 48910</p> <p><b>Wisconsin</b> 6011 Odana Rd Madison, WI 53719</p>
<b>Region 6</b>	<p><b>Arkansas</b> Federal Building 700 W Capitol Street, Rm 1433 Little Rock, AR 72201</p> <p><b>Oklahoma</b> Shephard Mall 2615 Villa Prom Oklahoma City, OK 73107</p>	<p><b>Louisiana</b> 350 N Donmoor Ave Baton Rouge, LA 70806</p> <p><b>Texas</b> 903 San Jacinto Blvd, Suite 102 Austin, TX 78701</p>	<p><b>New Mexico</b> 1911 Fifth Street, Suite 101 Santa Fe, NM 87505</p>
<b>Region 7</b>	<p><b>Iowa</b> Federal Building 210 Walnut Street, Room 293 Des Moines, IA 50309</p> <p><b>Nebraska</b> 100 Centennial Mall N, Room 191 Lincoln, NE 68508</p>	<p><b>Kansas</b> 1201 SW Van Buren St Topeka, KS 66612</p>	<p><b>Missouri</b> 3523 Amazonas Drive Jefferson City, MO 65109</p>
<b>Region 8</b>	<p><b>Colorado</b> 1616 Champa Street, 4<sup>th</sup> Floor Denver, CO 80202</p> <p><b>South Dakota</b> Federal Building 200 4<sup>th</sup> Street, Room 105 Huron, SD 57350</p>	<p><b>Montana</b> Suite 1600 10 W. 15<sup>th</sup> Street Helena, MT 59601</p> <p><b>Utah</b> 202 West 400 South Salt Lake City, UT 84101</p>	<p><b>North Dakota</b> 1680 E. Capitol Ave. Bismarck, ND 58501</p> <p><b>Wyoming</b> 5353 Yellowstone Cheyenne, WY 82009</p>
<b>Region 9</b>	<p><b>Arizona</b> 16241 N. Tatum Blvd. Phoenix, AZ 85032</p> <p><b>Nevada</b> 1175 Financial Blvd Reno, NV 89502</p>	<p><b>California</b> 8351 Folsom Boulevard Sacramento, CA 95826</p>	<p><b>Hawaii</b> Federal Office Building 300 Ala Moana Blvd, Room 1-114 Honolulu, HI 96850</p>

<b>Region 10</b>	<b>Alaska</b> 222 W 8 <sup>th</sup> Avenue, Room 66 Anchorage, AK 99513- 7505  <b>Washington</b> 402 Yauger Way SW Olympia, WA 98502- 5068	<b>Idaho</b> 1249 S. Vinnell Way Suite 101 Boise, ID 83709-1678	<b>Oregon</b> Suite 530 Center Street NE, Suite 350 Salem, OR 97301-3771
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## Chapter 9

# Internal Revenue Service

## Overview

The Internal Revenue Service (IRS), an agency of the Department of Treasury, is the Federal agency charged with the administration of the tax laws passed by Congress. The IRS for many years was organized geographically with a national office in Washington and regional, district and local offices throughout the country. With the Restructuring and Reform Act of 1998, the Internal Revenue Service has undergone major changes in an effort to improve customer service. This restructuring, expected to take several years, marks the most sweeping overhaul of the agency since 1952. The reorganization and its impact on Federal, state, and local government entities will be discussed in this chapter.

IRS is responsible for administering and enforcing the Internal Revenue Code (IRC) and related statutes except those relating to alcohol, tobacco, firearms and explosives. The mission of the newly reorganized IRS is to provide customers top quality service by helping them understand and comply with applicable tax laws and to protect the public interest by applying the tax law with integrity and fairness to all. The IRS:

- strives to achieve the highest possible degree of voluntary compliance in accordance with the tax laws and regulations;
- advises the public of its rights and responsibilities;
- determines the extent of compliance and the causes of noncompliance;
- administers and enforces the tax laws; and
- develops and implements more efficient ways of accomplishing its mission.

### Basic activities include:

- ensuring satisfactory resolution of taxpayer complaints, providing taxpayer service and education;
- determining, assessing and collection of Internal Revenue taxes;
- determining pension plan qualifications and exempt organizations status; and
- preparing and issuing rulings and regulations to supplement the provisions of the IRC.

The source of most revenue collected is withheld income tax and social security taxes, with other major sources being the corporate income, excise, estate and gift taxes.

Congress first received authority to levy taxes on the income of individuals and corporations in 1913, pursuant to the 16<sup>th</sup> amendment of the U.S. Constitution.

## Organization

In October, 2000, Internal Revenue Service's practice of dividing the nation's taxpayers by geographic boundaries was replaced with a new system built around four specific customer bases (groupings of taxpayers determined to have common needs). The new structure is intended to reduce the number of management layers in the agency.

**National Headquarters**, located in Washington, D.C. continues to develop nationwide policies and programs for the administration of the IRS. National Headquarters is headed by the Commissioner of Internal Revenue and the Commissioner's Senior Staff, who provide direction for the four new Operating Divisions, four **Functional Divisions**, **Modernization Systems** (Business Systems Modernization and Information Technology Services), and **Agency Wide Shared Services (AWSS)**. This organization replaces the Regional, District Offices, and ten Service Centers.

The **Office of Chief Counsel**, also at National Headquarters, provides independent legal counsel to the Internal Revenue Service. Its mission is to provide the correct legal interpretation of the Internal Revenue Code; represent the IRS in litigation; provide for all other legal support for the IRS; and perform these duties in a manner that enhances public confidence in the integrity, efficiency, and fairness of the nation's tax system.

The, four **Operating Divisions** (representing the four distinct customer bases) are as follows:

### Operating Division

### Customer Base

Wage and Investment

Individual taxpayers (filing Forms 1040 with no Schedule C, E, F, 2106, or international activity)

Small Business and Self-Employed

Filers for S-corporations, partnerships, and small corporations, and individual taxpayers with Schedule C, E, F, 2106 or international activity

Filers of estate and gift tax, fiduciary returns, international tax returns.

Large and Midsize Business

Filers for S-corporations, partnerships, and corporations with assets greater than \$5 million that require sophisticated tax planning.

Tax Exempt and Government Entities

Filers of information returns and tax returns that pertain to employee plans, exempt organizations, and government entities.

Each of the four Operating Divisions has its own Counsel to provide legal expertise and guidance.

**Functional Divisions** (including existing and newly created functions) offer supporting services to these Operating Divisions, as follows:

<b>Functional Division</b>	<b>Purpose</b>
Appeals	Resolves tax controversies without litigation in a fair and impartial environment.
Communications and Liaison	Promotes understanding and relationships with stakeholders, balances confidentiality rights with rights to information.
Criminal Investigation	Investigates potential criminal violations of the Internal Revenue Code.
Taxpayer Advocate Service	Helps taxpayers to resolve problems with the IRS.

### ***Tax Exempt and Government Entities Operating Division***

The **Tax-Exempt and Government Entities (TEGE)** Operating Division was established in late 1999 and replaced the former office of Assistant Commissioner (Employee Plans and Exempt Organizations). It serves three very distinct customer segments: **Employee Plans**, **Exempt Organizations**, and **Government Entities**. Customers range from small local community organizations and municipalities to major universities, huge pension funds, state governments, Indian tribal governments and the complex tax-exempt bond community. These organizations represent a large economic sector with unique needs. They are governed by highly complex, highly specialized provisions of the tax law.

**Government Entities** contains three components:

**Tax-Exempt Bonds (TEB)**

**Indian Tribal Governments (ITG)**

**Federal, State, and Local Government (FSLG)**

**Tax-Exempt Bonds:** provides information to the tax-exempt bond community in the form of education and outreach programs. It encourages voluntary compliance through ruling and agreement efforts. It also administers and conducts the tax-exempt bond examination program.

**Indian Tribal Governments:** helps Indian tribes deal with their Federal tax matters and provides a single point of contact for assistance and service. The specialists in this area address issues and provide guidance unique to Indian tribes, whose concerns may relate to tribal governments as employers, distributions to tribal members, and the establishment of governmental programs, trusts, and businesses.

**Federal, State, and Local Governments (FSLG):** provides a clear point of contact for all government entities for their tax issues with the primary focus on information return reporting and employment tax issues. It develops and delivers tailored communication and education programs and provides easily accessible and equitable voluntary

compliance programs for its government customers. FSLG is also responsible for administering the tax laws and ensuring compliance.

On the following pages, you will find the following information:

- ✓ The areas of jurisdiction for Federal, State, and Local Governments and National Headquarters FSLG personnel names, addresses, and telephone numbers;
- ✓ Area managers and management assistants for each area of the country that services **Federal, State, and Local Governments**;
- ✓ Areas of jurisdiction for Indian Tribal Governments (ITG) and National Headquarters ITG personnel names, addresses, and telephone numbers; and
- ✓ Area managers and management assistants for each area of the country that services **Indian Tribal Governments**.

## **QUESTIONS AND ANSWERS**

### **1. What information can IRS share with SSA and under what circumstances?**

Section 6103 of the IRC governs the disclosure of tax information by the IRS to other Federal and state agencies. SSA obtains tax information from IRS under several provisions of section 6103 to administer the social security laws. Questions concerning what can be disclosed by IRS to SSA should be directed to the local IRS Disclosure Officer. [IRS]

### **2. What information can IRS share with the State Social Security Administrator and under what circumstances?**

Section 6103 of the IRC governs the disclosure of tax information by the IRS to other Federal and state agencies. Without the consent of the taxpayer, no provision in section 6103 would authorize the IRS to share specific taxpayer information with State Social Security Administrators. However, in performing a tax investigation, the IRS may go to the State Social Security Administrator to obtain information for the investigation. [IRS]

### **3. What information can IRS share with a public employer and under what circumstances?**

Section 6103 of the IRC permits the IRS to disclose information about a taxpayer's tax liability to that taxpayer, including disclosures to a public employer about that public employer's social security and Medicare tax liability. [IRS]



## **Federal, State, and Local Governments**

### **National Headquarters**

Allen P. Jones, Director, FSLG  
Internal Revenue Service  
T:GE:FSLG  
1111 W. Constitution Avenue NW  
Washington, D.C. 20224  
Telephone: (202) 283-9818  
FAX Number: (202) 283-9797

### **National Headquarters**

Jan M. Schlegel, Manager,  
Outreach Planning and Review Staff  
Internal Revenue Service  
T: GE: FSLG:OPR  
1111 W. Constitution Avenue NW  
Washington, D.C. 20224  
Telephone: (202) 283-9799  
FAX Number: (202) 283-9797

***Listing of Area Managers and Management Assistants for Federal, State, and Local Governments (by Area of Jurisdiction)***

<b>Area 1, Pacific Coast (includes Alaska, California, Hawaii, Nevada, Oregon, Washington, Pacific Territories)</b>	
Cheryl Powers, Area Manager Internal Revenue Service T: GE: FSLG: 7254 185 Lennon Lane Walnut Creek, CA 94598 Telephone: (925) 279-4012, X203 FAX Number: (925) 279-4040	Garrett Rigoni, Management Assistant Telephone: (925) 279-4011, X204
<b>Area 2, Western (includes Arizona, Colorado, Idaho, Montana, New Mexico, Utah, Wyoming)</b>	
Area Manager (Vacant) Internal Revenue Service T:GE:FSLG:7256 2864 South Circle Drive, 7 <sup>th</sup> Floor Colorado Springs, CO 80906 Telephone: (719) 579-0387, X260 FAX Number: (719) 579-8514	Management Assistant not yet selected
<b>Area 3, Midwest (includes Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota)</b>	
Dan Wiseman, Area Manager Internal Revenue Service T:GE:FSLG:7255 - Stop 4556WIC 271 West 3 <sup>rd</sup> North Wichita, KS 67202 Telephone: (316) 352-7421 FAX Number: (316) 352-7255	Yalonda Dennis, Management Assistant Telephone: (316) 352-7412
<b>Area 4, Gulf Coast (includes Alabama, Arkansas, Louisiana, Mississippi, Oklahoma, Texas)</b>	
David Hirschman, Area Manager Internal Revenue Service T:GE:FSLG:7252 300 East 8 <sup>th</sup> Austin, TX 78701 Telephone: (512) 499-5421 FAX Number: (512) 499-5780	Jacqueline Cunningham, Mgmt Assistant Telephone: (512) 499-5235

***Listing of Area Managers and Management Assistants for Federal, State, and Local Governments (by Area of Jurisdiction)***

<b>Area 5, Central (includes Illinois, Indiana, Iowa, Michigan, Ohio, Wisconsin)</b>	
Michael Pupillo, Area Manager Internal Revenue Service T:GE:FSLG:7253 860 Algonquin Road Schaumburg, IL 60173 Telephone: (847) 303-3165 FAX Number: (847) 303-4528	Diane Forsberg, Management Assistant Telephone: (847) 303-3166
<b>Area 6, Southeast (includes Florida, Georgia, Kentucky, North Carolina, South Carolina, Tennessee, Atlantic Possessions)</b>	
Willie Clayton, Area Manager Internal Revenue Service T:GE:FSLG:7250 850 Trafalgar Court Maitland, FL 32751 Telephone: (407) 660-5822, X210 FAX Number: (407) 660-5875	Sharon McDonald, Management Assistant Telephone: (407) 660-5822, X211
<b>Area 7, Northeast (includes Maine, Massachusetts, New Hampshire, New York, New Jersey, Rhode Island, Vermont)</b>	
Donald Palermo, Area Manager Internal Revenue Service T:GE:FSLG:7251 255 East Avenue Rochester, NY 14604 Telephone: (716) 263-5730, X127 FAX Number: (716) 263-5857	Deborah A. Bowick, Mgmt Assistant Telephone: (716) 263-5730, X128
<b>Area 8, Mid-Atlantic (includes Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia)</b>	
Gerald Masters, Area Manager Internal Revenue Service T:GE:FSLG:7257 600 Arch Street, Room 4454 Philadelphia, PA 19106 FAX Number: (215) 861-1695	Elizabeth Grant, Management Assistant Telephone: (215) 861-1497

## Indian Tribal Governments

### National Headquarters

Christie J. Jacobs, Director, ITG  
 Internal Revenue Service  
 T:GE:ITG (Room 562)  
 1111 W. Constitution Avenue NW  
 Washington, D.C. 20224  
 Telephone: (202) 283-9800  
 FAX Number: (202) 283-9760

### National Headquarters

Tracy Moore, Management Assistant  
 Internal Revenue Service  
 T:GE:ITG (Room 5J1)  
 1111 W. Constitution Avenue NW  
 Washington, D.C. 20224

### ***Listing of Area Managers and Management Assistants for Indian Tribal Governments (by Area of Jurisdiction)***

<b>Southwest (includes Arizona, Colorado, New Mexico, Utah)</b>	
Steve D. Bowers, Manager T:GE:ITG:727 34 Civic Center Plaza Santa Ana, CA 92712 Telephone: (714) 836-2047	Management Assistant (Vacant)
<b>Western (includes California, Hawaii, Nevada)</b>	
John Saltmarsh, Manager T:GE:ITG:727 290 N. D Street San Bernardino, CA 92402 Telephone: (909) 388-8162	Sandra Leggett Management Assistant (909) 388-8115
<b>Pacific Northwest (includes Alaska, Idaho, Oregon, Washington)</b>	
Debra W. Thompson, Manager T:GE:ITG:727 4750 W. Oakey Boulevard Las Vegas, NV 89102-1500 Telephone: (702) 455-1379	Connie Albertson Management Assistant (702) 455-1247

***Listing of Area Managers and Management Assistants for Indian Tribal Governments (by Area of Jurisdiction)***

<b>Eastern United States &amp; Southern Plains (includes Alabama, Arkansas, Connecticut, Delaware, Florida, Georgia, Indiana, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia, West Virginia)</b>	
Ken Voght T:GE:ITG:727 Appletree Business Park Cheektowaga, NY 14227 Telephone (716) 686-4860	Elizabeth Gabbey Management Assistant (716) 686-4861
<b>North Central (includes Illinois, Iowa, Kansas, Michigan, Minnesota, Missouri, Montana, Nebraska, North Dakota, South Dakota, Wisconsin, Wyoming)</b>	
John Walters T:GE:ITG:727 657 2 <sup>nd</sup> Avenue N Fargo, N.D. 58102 Telephone: (701) 239-5400	Cheryl Bauer Management Assistant (701) 239-5400 Ext. 243



## Chapter 10

# Public Employer Responsibilities

### State Government

A state, for purposes of a Section 218 Agreement, includes the 50 states, Puerto Rico, the Virgin Islands, and interstate instrumentalities. It does not include the District of Columbia, Guam, or American Samoa.

### **Authority**

The states have primary responsibility for many aspects of government. The 10th Amendment to the U.S. Constitution reserves to the states or to the people all powers not delegated nor prohibited by the Constitution. Sometimes the state receives Federal aid for specific programs. Some services for which the state has primary responsibility include:

- Protection of lives and property by maintenance of a police force;
- Regulation and improvement of transportation within the state;
- Regulation of business within the state; and
- Education.

In many cases, the Federal and state governments work as partners, with the Federal government providing most of the funding and the state providing distribution. Some of these services include:

- Health care;
- Public assistance for persons in need;
- Protection of natural resources; and,
- Improvement in living and working conditions. (Source: *U.S. Government Structure*)

### Local Government

Local governments include *political subdivisions* of states and are different from state and Federal governments because their authority is not based directly on a constitution. Instead, each state constitution describes in detail a procedure for establishing local governments. Usually the state legislature has to approve the creation or incorporation of a local government. The local government then receives a charter defining its organization, authority and responsibilities. All local governments have an elected government.

The jurisdiction and names vary in legal meaning from state to state. Local government units may be named borough, city, county, township, village, district, etc.

A political subdivision for purposes of a Section 218 Agreement includes an instrumentality of a state, one or more of the political subdivisions of a state, or a state and one or more of its political subdivisions. It is a separate legal entity of a state and usually has specific governmental functions. A political subdivision ordinarily includes a county, city, township, town, village, as well as school, water, utility, sanitation, recreation and housing districts and authorities, and other similar governmental entities. (Contact the State Social Security Administrator to determine an entity's status for Section 218 purposes.)

### ***Authority***

The authority of local governments varies almost as much as the types of local governments. Generally, a local government has the authority to:

- ◆ Raise taxes,
- ◆ Try people accused of breaking local laws or ordinances, and
- ◆ Administer local programs within its boundaries.

Local governments generally provide services as needed by the local area (such as building a bridge over a river) or protective services (such as police and fire protection).

Local governments receive financial aid from state and Federal governments in providing these services according to need. Some of the services for which local governments take primary responsibility include:

- ◆ Ensuring the safety of drinking water,
- ◆ Protecting public health and safety,
- ◆ Building and repairing local roads and streets,
- ◆ Providing police and fire protection,
- ◆ Collecting garbage,
- ◆ Maintaining schools,
- ◆ Conducting and coordinating elections,
- ◆ Maintaining courts, courthouses and jails,
- ◆ Collecting taxes for local and state governments, and
- ◆ Keeping official records such as marriage, birth and death. (Source: *U.S. Government Structure*)



The Bureau of the Census estimated that in 1997, there were 87,453 local governments in the United States.

## **Indian Tribes**

The legal relationship between the United States and Indian tribal governments is set forth in the Constitution, treaties, statutes, and court decisions. Congress may limit the authority of Indian tribes, but, within those limits, the tribes retain attributes of sovereignty over both their members and their territory.

### **Authority**

Tribal governmental power includes the authority to:

- Choose the form of tribal government,
- Determine tribal membership,
- Regulate tribal and individual property,
- Levy taxes,
- Establish courts, and
- Maintain law and order.

Generally, Indian tribes provide government services, such as transportation, education, and medical care to reservation Indians.

## **Instrumentalities for FICA Purposes**

An instrumentality is an organization created by or pursuant to state statute, operated for public purposes, and expressly declared by statute to be an instrumentality. Generally an instrumentality performs governmental functions but does not have the full powers of a government, i.e., police, tax, and eminent domain. Questions concerning the status of an instrumentality, for social security and Medicare purposes, should be directed to the IRS. Questions concerning the status of an instrumentality for Section 218 Agreement purposes should be addressed to the State Administrator or the SSA.

A wholly-owned instrumentality of a state or political subdivision is treated as a state or local government employer for purposes of the mandatory social security and Medicare provisions. See IRC section 3121(b)(7)(F).

In determining whether an organization is wholly owned by one or more states or political subdivisions, the following factors are taken into consideration:

1. Whether it is used for a governmental purpose and performs a governmental function;
2. Whether performance of its function is on behalf of one or more states or political subdivisions;
3. Whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner;

4. Whether control and supervision of the organizations is vested in public authority or authorities;
5. Whether express or implied statutory authority is necessary for its creation and/or use, and whether such authority exists; and
6. The degree of financial autonomy and the source of operating expenses. An instrumentality owned by more than one state can be a wholly-owned instrumentality. (See Rev. Rul. 57-128.)

### ***Qualifications of Instrumentalities***

Schools, hospitals and libraries, as well as associations formed for public purposes, such as soil and water conservation, may or may not be instrumentalities. State sponsorship of an organization, state regulation of its activities, the participation of its employees in a public retirement system, and operation with public funds are among the factors to be considered in determining whether an organization is an instrumentality. If an organization is essentially under private ownership and control, it is not an instrumentality.

Associations formed for conservation, protection and promotion, although they may carry out a public purpose, may not rise to the level of state instrumentalities. The following associations may or may not be state instrumentalities:

- Soil and water conservation districts
- Fire associations that protect forestland
- Associations that promote a state or municipality

Documents that establish statutory authority under which the entity was established are required for status determination.

The following examples apply the tests of Revenue Ruling 57-128 to determine whether they are wholly-owned instrumentalities.

**Soil and Water Conservation Districts.** Entities whose revenues are principally generated from fees collected from land owners within the district may or may not be instrumentalities, depending upon application of the factors listed above, including whether the district is under public or private control.

***Example:** A soil conservation district in Minnesota was established to carry out a state conservation program. The Soil Conservation Service of the U.S. Department of Agriculture furnished the district with technical and clerical personnel. The disbursements of the district were made from fees collected from members (occupiers of the land within the district) for services rendered from funds allocated by the U.S. Department of Agriculture and from state appropriations. The soil conservation district was created by statute as a political subdivision of the state and was under the control of a board of supervisors elected or appointed in accordance with state law. This is a political subdivision of the state. [Revenue Ruling 57-120, 1957-1, 310]*

**Example:** *A Connecticut soil and water conservation district was formed as a private nonstock corporation by private individuals. The state had authority to assist private individuals in forming conservation districts but did not have the power to operate them. The private individuals had complete control over the corporate operations, revenue and expenditures. Therefore, the soil and water conservation district is not a wholly-owned instrumentality of the state. [Revenue Ruling 69-453, CB 1969-2, 182]*

**Fire associations.** Fire associations may or may not be instrumentalities, depending on whether they are under public or private control.

**Example:** *A fire association was organized pursuant to an Oregon state law that required all forest land in the state to be adequately protected from the dangers of fire. While the fire association was organized as a result of an Oregon law, it was organized and operated for the mutual benefit of its members, and was not an instrumentality of the state. Furthermore, except for the work it performed on a cost basis for the state and Federal government, the association derived most of its support from assessments made on its members. [Revenue Ruling 70-483, CB 1970-2, 201]*

**Example:** *Under the laws of the state of Pennsylvania, townships have the authority to purchase fire engines and fire apparatus out of general township funds for use of the township and to appropriate money to fire companies located in the township in order to secure fire protection. Members of volunteer fire departments organized under the laws of Pennsylvania are employees of the political subdivision. [Revenue Ruling 70-484, CB1970-2, 202]*

**Associations that Promote a State or Municipality.** State sponsorship of promotional activities isn't enough to raise an association to instrumentality status.

**Example:** *A municipal league comprised of qualified officials of member cities or villages, but with no control and supervision vested in a public authority, is not a state instrumentality. The League's activities consisted of publishing a monthly magazine featuring articles on governmental matters, conducting conferences and sponsoring and participating in municipal law institutes and seminars. The state had no statute for the incorporation of a league of this nature as an instrumentality. [Revenue Ruling 65-26, 1965-1, 444]*

**Note:** *Some state statutes specifically create certain associations as instrumentalities. A review of the establishing legislation is required for status determination.*

### ***Interstate Instrumentalities***

An interstate instrumentality is an independent legal entity organized by two or more states to carry on governmental functions, such as a regional planning authority, a regional transportation system or a regional water district. There may be FICA liability with regard to services performed by employees of interstate instrumentalities. For social security coverage purposes under Section 218, an interstate instrumentality is treated as a state.

If an interstate instrumentality covers its employees with a retirement system a referendum must be held prior to the execution of the 218 agreement. All interstate instrumentalities are authorized to divide a retirement system on the basis of the desires of the members, in addition to being able to conduct a majority vote referendum. Employees of an interstate instrumentality who are not covered for social security under a Section 218 Agreement, but who **are** qualified participants in a public retirement system, are **not** covered for social security even if the employer continues to withhold and report such taxes.

## **Wages and Employment Taxes**

Taxes under the Federal Insurance Contributions Act (social security and Medicare) consist of Old-Age, Survivors and Disability Insurance and Medicare Hospital Insurance taxes. The Internal Revenue Code (IRC) section 3101 imposes a tax on the employee, and section 3111 imposes a tax on the employer. The state or local entity must collect and pay the employee's part of the taxes and must pay the employer's part.

IRC section 3121(a) provides that wages include all remuneration for employment, whether paid in cash or in some other form, unless specifically excepted by statute. Some examples of wages for social security and Medicare purposes are salaries, fees, bonuses, prizes, awards and commissions. It is immaterial whether the payments are based on the hour, week, month, year, piecework, or on a percentage basis.

The social security wage and benefit base applies to the remuneration received from each employer and not to the aggregate remuneration received from all employers. (Beginning in 1994, there is no wage base limit for Medicare tax.) Consequently, if an employee works for more than one employer in one calendar year, excess social security taxes may be withheld. In order to get a refund of the excess social security tax withheld by the employers, the employee shows the overpayment on Form 1040. Employers, however, may not claim a refund because each employer is responsible for withholding and paying social security tax on wages paid to each employee up to the wage base.

For the purpose of determining responsibility for reporting wages, a state is considered to be one employer and each political subdivision is considered a separate employer. An employee who transfers from one state agency to another during a calendar year does not change employers. The state should withhold and pay social security tax only up to the wage base for that employee. An employee who transfers from a state agency to a political subdivision, a city or county, *has* changed employers. Each employer must withhold and pay social security tax up to the wage base for that employee.

## **Noncash Payments**

Generally, noncash payments **are wages** subject to social security and Medicare. Wages paid in a medium other than cash should be computed based on the fair market value at the time of payment. The fair market value may be based on the prevailing value of the items in the locality or upon a reasonable value established for other purposes.

## **Back Pay**

Back pay is pay received in a tax year for actual or deemed employment in an earlier year. For social security coverage and benefit purposes, **all** back pay is wages except amounts specifically and legitimately designated otherwise, e.g., interest, penalties, and legal fees. For tax purposes, back pay is treated as wages in the year received and is reported on Form W-2 for that year. Social security and Medicare tax and income tax withholding apply in the year of payment at the rates in effect for that period.

The period for which back pay is credited as wages for social security purposes is different if the back pay is awarded under a statute. However, payments of back pay under a statute will remain posted to the employee's social security earnings record in the year reported on Form W-2 unless the employer or employee notifies the SSA in a special, separate report of the payment of back pay under a statute. If this is done, SSA can allocate the statutory back pay to the appropriate periods. See IRS Publication 957 for more information.

## **Fringe Benefits**

Generally, fringe benefits must be included in an employee's gross income and are subject to social security and Medicare as well as income taxes. Fringe benefits include vehicles for personal use, tickets to entertainment or sporting events, etc. Some fringe benefits are nontaxable. See IRS Publication 15-B for further details.

## **Business Expense Reimbursements**

Payments to employees for travel and other ordinary and necessary expenses of the employer's business generally are wages subject to social security and Medicare and withholding unless paid under an "accountable plan". See IRC section 62(c) and section 1.62-2, Income Tax Regulations. There are three requirements for an accountable plan:

- (1) The expenses must be deductible as business expenses incurred while performing services for the employer;
- (2) The employee must adequately account for the expenses to the employer within a reasonable period of time, and
- (3) The employee must return any amounts in excess of expenses within a reasonable period of time.

Allowances at the Federal rates or less for mileage, lodging, meals and incidental expenses are deemed substantiated.

## **Employer-Provided Vehicles**

If an employer provides an employee with unrestricted use of a vehicle, the employee receives a noncash fringe benefit and the value is required to be included in income. The value of the vehicle is included in income unless the employee substantiates its business use. See IRC section 274(d) and section 1.274-5T, Income Tax Regulations.

There are three methods for determining the value of the use of a vehicle:

- Cents-per-mile rule

- Commuting rule
- Lease value rule

These rules are discussed in IRS Publication 15-B, *Employer's Tax Guide to Fringe Benefits*.

An employee is allowed to exclude from income the value of any property or services provided by the employer to the extent that, if the employee paid for the property or services, the payment would be allowable as a business expense deduction. See IRC section 132(a)(3). This is called a working condition fringe.

Under certain circumstances, the value of a “qualified nonpersonal use vehicle” can be excluded from income as a working condition fringe. A qualified nonpersonal use vehicle is one that, due to its nature, is not likely to be used more than a minimal amount for personal purposes. This includes, for example, a clearly marked police or fire vehicle, a flatbed truck, a school bus, ambulance, etc. An employee does not have to substantiate the business use of a nonpersonal use vehicle in order to exclude its value from income. See IRC section 274(d)(i).

### **Cafeteria Plans**

Cafeteria plans, including flexible spending arrangements, are benefit plans under which employees can choose from among cash and certain qualified benefits. If the employee elects qualified benefits, employer contributions are excluded from wages if the benefits are excludable from gross income under a specific section of the Internal Revenue Code (other than scholarship and fellowship grants under section 117 and employee fringe benefits under section 132). The cost of group-term life insurance that is includible in income only because the insurance exceeds \$50,000 of coverage is considered a qualified benefit. Generally, qualified benefits under a cafeteria plan are not subject to social security and Medicare taxes or income tax withholding. However, group-term life insurance that exceeds \$50,000 of coverage and adoption benefits are subject to social security and Medicare taxes, but not to income tax withholding, even when provided as qualified benefits in a cafeteria plan. If an employee elects to receive cash instead of any qualified benefit, it is treated as wages subject to all employment taxes. See IRS Publication 15-B, *Employer's Supplemental Tax Guide*, for further details.

### **Meals and Lodging**

The value of meals and lodging is not wages **if** furnished on the business premises of the employer **and** for the convenience of the employer. There is one additional requirement that applies to lodging: the employee must be required to accept lodging as a condition of employment. See IRS Publication 15 for more information.

### **Deceased Employee's Wages**

If an employee dies during the year, the employer must report the accrued wages, vacation pay, and other compensation paid after the date of death. If the employer made the payment in the same year the employee died, the payment and social security and Medicare taxes must be reported [on](#) Form W-2. On Form W-2, show the payment as social security wages (box 3) and Medicare wages and tips (box 5). Show the social

security and Medicare taxes withheld in boxes 4 and 6. **Do not show the payment in box 1.** If you made the payment *after* the year of death, do not report it on Form W-2 and do not withhold social security and Medicare taxes. See the Instructions for Forms W-2 and W-3 for more information.

If the payment is made after the year of death, report it in box 3 of **Form 1099-MISC**, Miscellaneous Income, as a payment to the estate or beneficiary. Use the name and taxpayer identification number (TIN) of the estate or beneficiary on Form 1099-MISC. See Revenue Ruling 86-109, 1986-2 C.B.196.

### **Sick Pay**

Sick pay is an amount paid to an employee because of sickness or injury. Sick pay is generally subject to social security and Medicare taxes **and** income tax withholding if paid by the employer. The employer withholds on the basis of the employee's Form W-4. Sick pay is sometimes paid by a third party, such as an insurance company or employee trust. The rules on third party withholding, paying and reporting social security and Medicare taxes differ, depending upon whether the third party is an agent of the employer or an insurer and the terms of an agreement between the employer and agent or insurer.

If the third party payer does not withhold income tax, the employee may request income tax withholding by giving the third party a Form W-4S (Request for Federal Income Tax Withholding from Sick Pay).

The following types of sick pay or injury pay are **not** subject to social security and Medicare taxes:

1. Payments received under a worker's compensation law,
2. Payments, or portions of payments, attributable to the employees' contributions to a sick pay plan,
3. Payments made for the same sickness or injury more than six months after the last calendar month in which the employee worked.

See IRS Publication 15-A for more details on third-party sick pay.

### **Vacation Pay**

Vacation pay is wages and subject to social security and Medicare tax and income tax withholding.

### **Federal Unemployment Tax Act (FUTA)**

The Federal Unemployment Tax Act (FUTA) provides a Federal-state insurance system for workers who lose their jobs. Most employers pay both a Federal and state unemployment tax. States and their political subdivisions are exempt from paying tax under FUTA. However, state and local government employees, with certain exceptions, must be covered by state unemployment insurance.

## **FUTA Exception for Indian Tribal Members**

Federally recognized Indian tribal governments are exempt from FUTA tax for services rendered to them after December 20, 2000. Instead, an Indian tribal government may elect to make contributions to the state unemployment fund as if services by its employees were employment under FUTA. Or the Indian tribal government may make separate elections for any subdivision, subsidiary, or business enterprise wholly owned by it. (IRC section 3306(c)(7)).

## **Federal Income Tax Withholding**

Employers are required to withhold Federal income tax from the wages paid to employees. The withheld amount is credited to the employees' individual income taxes.

The amount of Federal income tax withheld depends on five factors:

1. Payroll period,
2. Employee marital status,
3. Amount of wages,
4. Number of withholding allowances claimed by the employee, and
5. Additional amounts the employee requests to be withheld.

Each employee should be provided with a Form W-4 to claim the appropriate number of withholding allowances and identify marital status. The signed Form W-4 must be kept on file for each employee. If an employee does not complete a Form W-4, the employer is required to withhold tax as if the employee were a single person claiming no withholding allowances. If not enough tax is withheld, the employee may be subject to penalties. Generally, Forms W-4 are for the employer's records and do not need to be sent to the IRS unless:

1. An employee claims more than 10 allowances, or
2. The employee normally earns more than \$200 per week and claims exemption from withholding.

There are two common ways to determine the amount of Federal income tax to be withheld: the wage bracket method and the percentage method. Tables for both methods are found in IRS Publication 15. Alternative methods of withholding are explained in IRS Publication 15-A, including methods for annualized wages, average estimated wages, cumulative wages, and part-year employment methods.

Generally, the wage bracket method is the easiest to use. However, for amounts of pay or pay periods not included in the tables, the percentage method may be needed. Any method may be used if it achieves approximately the same withholding.

## **Section 457 Plans**

Social security and Medicare taxes are generally levied upon deferrals to an eligible section 457(b) deferred compensation plan at the later of the time 1) when the services giving rise to the related compensation are performed or 2) when there is no substantial risk of forfeiture of the rights to the amounts. For further information regarding social security and Medicare tax withholding and reporting on amounts deferred into eligible deferred compensation plans, see Section V of Notice 2000-38 in the Appendix.



Amounts deferred into an eligible section 457(b) deferred compensation plan are not subject to income tax withholding until they are distributed from the plan or made available to the participant or beneficiary. For further information regarding income tax reporting and withholding upon amounts deferred into and distributed from eligible deferred compensation plans, see Section IV of Notice 2000-38.

## **Supplemental Wages**

Supplemental wages are compensation paid to an employee in addition to the employee's regular wages (e.g., overtime pay, severance pay, awards, back pay, payments for non-deductible moving expenses, etc.). Supplemental wages are subject to social security and Medicare and income tax withholding.

If an employer pays supplemental wages with regular wages but does not specify amounts of each, income tax should be withheld as if the total were a single payment for a regular payroll period.

If an employer pays supplemental wages separately (or combines them in a single payment and specifies the amount of each), the income tax withholding method depends partly on whether the employer withheld income tax from the employee's regular wages.

If the employer withheld income tax from regular wages, one of the following methods for the supplemental wages can be used:

1. Withhold at a flat 27% rate, **or**
2. Add the supplemental and regular wages for the most recent payroll period this year. Then figure the income tax withholding as if the total were a single payment. Subtract the tax already withheld from the regular wages. Withhold the remaining tax from the supplemental wages.

If the employer did not withhold income tax from the employee's regular wages, method 2 above should be used.

## **Employer Identification Number**

IRS keeps track of individual taxpayers by using a taxpayer identification number (TIN). For individuals, the TIN is the social security number. State and local entities use Employer Identification Numbers (EINs) assigned by IRS to identify their tax returns. EINs should be used on all employment tax returns, information returns and correspondence with the IRS. Generally, each county, city, school district and other governmental unit will have a unique EIN. However, this is not always the case within state governments. Many state agencies may use an EIN assigned to another agency; some larger state agencies may use a unique EIN.

When one municipality annexes another, or when school districts are combined, the EIN of the annexed area or abolished district should no longer be used, as it is no longer a separate entity. When an unincorporated area is incorporated, it becomes a separate entity and must obtain its own EIN. To obtain a new EIN, complete a Form SS-4.

Check the EIN for accuracy and completeness on each tax document submitted. When an incorrect EIN is used, tax monies will be credited to the wrong account.

**Note:** EINs beginning with the digits 69 are SSA-assigned employer identification to report earnings for tax years prior to 1987 but are no longer used. Prior to 1987, these numbers were assigned for new modifications to Section 218 Agreements and then used to process wage reports. Many states have a filing system based upon the 69-number and, therefore, continue to sequentially assign 69-numbers for internal recordkeeping purposes.

## **Advance Earned Income Credit**

The Earned Income Credit (EIC) is a tax credit for workers who have earned income below specific thresholds. Eligible employees can choose to collect part of the earned income tax credit during the year from their employers with their paychecks, or they can claim the entire amount on their tax returns at the end of the year.

Eligible employees who want to receive advance EIC payments during the year with their pay must complete Form W-5, Earned Income Credit Advance Payment Certificate. A state entity is required to make advance EIC payments to eligible employees who complete a Form W-5. See IRS Publication 15.

### **Form W-5**

On Form W-5, an employee states that he or she expects to be eligible for the EIC and shows whether he or she has a certificate in effect with any current employer. The employee also shows whether he or she is married, and, if married, whether his or her spouse has a certificate in effect with an employer. An employee may have only one certificate in effect with a current employer at one time. If an employee is married and his or her spouse also works, each spouse should file a separate Form W-5. Form W-5 remains in effect until the end of the calendar year unless the employee revokes the certificate or files another one. Eligible employees must file a new certificate each year.

An advance EIC payment is not wages and is not subject to withholding of income tax or social security and Medicare taxes. An advance EIC payment does not change the amount of income tax or social security and Medicare taxes withheld from the employee's wages. Add the EIC payment to the employee's net pay for the pay period. When the Form W-2 is completed for that year, show the total advance EIC payments in box 9, "Advance EIC Payment," of Form W-2. Do not include this amount in the "Wages" box.

Show the total payments made to employees on the advance EIC line of Form 941, discussed below. Subtract this amount from the total taxes. (See the instructions for Form 941.)

### **Required Notice to Employees**

State and local entities are required to notify employees who have no income tax withheld that they may be eligible for a tax refund because of the EIC. Employers are encouraged to notify employees eligible for EIC. Eligible employees may get a refund of the amount of EIC that exceeds any tax they owe. For further information on eligible employees, how to figure advance EIC payments, notification requirements, refer to IRS Publication 15.

## **Form 941**

**Form 941**, Employer's Quarterly Federal Tax Return, is used to report total wages, wages subject to social security and Medicare tax and Federal income tax and to reflect the total employer tax liabilities. Agricultural employers file **Form 943**, Employer's Annual Tax Return for Agricultural Employers.

To prepare Form 941, total wages and compensation must be determined. Wage payments are included in the quarter in which they are paid. For example, an employee works for the county on March 20, but is not paid until April 5. In this situation, the employee's wage payment is included in the second quarter when the payment is made, not the first quarter when the work was done. Total wages and compensation entered on line 2 of Form 941 includes all payments to employees. Examples of these payments are:

1. Wages, salaries, commissions, fees, and bonuses;
2. Vacation allowances;
3. Dismissal pay and severance pay;
4. Tip income; and
5. Noncash payments, goods, lodging, food, clothing or services given instead of cash.

Wages from which social security and Medicare tax must be withheld (line 6a) may differ from total wages. Earnings over the limit are not subject to the OASDI portion of social security tax. However, there are no limits on the earnings subject to Medicare tax (line 7). The total income tax withheld (line 3) includes all Federal income tax withheld from all employees for the calendar quarter covered by the return.

Form 941 must be filed with the IRS by the last day of the month following the reporting quarter. The first quarter return covering January through March is due by April 30<sup>th</sup>. If all taxes are deposited when due, the employer has 10 additional days after the due date to file the return. If the return is not filed by this date, the employer may be subject to penalties and interest in addition to the tax on the return.

### **Form 941c**

To correct errors in social security and Medicare taxes from prior quarters, make adjustments on line 9 of Form 941 for the quarter in which the error was discovered. Explain the adjustments on Form 941c (Supporting Statement to Correct Information) or on an attached statement. The explanation should include:

1. What the error was,
2. The ending date of the quarter in which the error was made,
3. The amount of the error,
4. The ending date of the quarter in which the error was found, and
5. Additional requirements found on the Form 941c.

Report the adjustments on line 17 of Form 941 or on Schedule B of Form 941, as explained in the instructions.

## **Depositing Taxes**

Employers deposit Federal employment taxes by using the Electronic Federal Tax Payment System (EFTPS) or by mailing or delivering a check, money order, or cash to an

authorized financial institution. Some employers are required to use EFTPS. See information on electronic deposit requirements below.

Two additional alternatives for the depositing of income tax withheld upon distributions from eligible section 457(b) plans (and for the reporting of such deposits) are provided in Section IV.E of Notice 2000-38.

## **Separate Deposit Requirements for Nonpayroll (Form 945) Tax Liabilities**

Separate deposits are required for nonpayroll income tax withholding. Do not combine deposits for employment tax liabilities with any other deposits, such as those for Form 945 (Annual Return of Withheld Federal Income Tax). Although deposited separately, the deposit rules for nonpayroll liabilities are the same as for payroll tax liabilities. See the instructions for Form 945 for details.

### **Electronic Deposit Requirement**

In order to determine whether your entity is required to use EFTPS to deposit taxes, you must “look back” to its total tax deposits (such as social security and Medicare taxes and excise taxes) in prior years. When an entity’s total depository taxes exceeds \$200,000 a year, it is required to make deposits using EFTPS for deposits made after December 31 of the following year. For example, if your entity’s total deposit of depository taxes in 2001 exceeded \$200,000, then you must make all deposits through EFTPS for deposits made after December 31, 2002. Once an entity is required to deposit through EFTPS, it must continue to use EFTPS in all succeeding years regardless of the amount of deposits it makes. Employers who are not required to make electronic deposits may voluntarily participate in EFTPS. For information on EFTPS, see IRS Publication 966, or call toll free 1-800-945-8400 or 1-800-555-4477. (These numbers are for EFTPS information only.)

### **When to Deposit**

There are two schedules—monthly or semiweekly—for deposit of Federal employment taxes. These schedules tell when a deposit is due after a tax liability arises (e.g., payday). Before the beginning of each calendar year, employers must determine which of the two deposit schedules they are required to use. The deposit schedule used is based on the total tax liability reported on Form 941 or Form 943 during a four-quarter lookback period as discussed below. **The deposit schedule is not determined by how often employees are paid.**

### **Lookback Period**

The deposit schedule for a calendar year is determined from the total taxes (not reduced by any advance EIC payments) reported on Forms 941 (line 11) in a four-quarter lookback period. The lookback period begins July 1 and ends June 30 of the preceding year. If the employer reported \$50,000 or less of taxes for the lookback period, it is a *monthly schedule depositor*; if it reported more than \$50,000, it is a *semiweekly schedule depositor*.

<b>Federal Tax Deposit (FTD) Fast Facts</b>		
<b>If the employer is a...</b>	<b>And the payroll date is...</b>	<b>Then a deposit must be made:</b>
Monthly schedule depositor <i>(\$50,000 or less during the lookback period)</i>	Any time during the month	On or before the 15 <sup>th</sup> of the month
Semiweekly schedule depositor <i>(More than \$50,000 during the lookback period)</i>	Saturday, Sunday, Monday, Tuesday	On or before the following Friday
	Wednesday, Thursday, Friday	On or before the following Wednesday
<p><b><u>Special Rules:</u></b></p> <p><b>\$2,500 Rule:</b> Taxes less than \$2,500 in a quarter do not have to be deposited if paid with a timely filed return.</p> <p><b>\$100,000 Next Day Rule:</b> \$100,000 or more within a deposit period must be deposited on the next banking day. Monthly depositors become semiweekly depositors on the next day and remain so for the remainder of the year and all of the following year.</p> <p><b>Accuracy of Deposit Rule:</b> An employer who inadvertently under-deposits will not be penalized if the shortfall is \$100 or 2% of the amount of employment taxes required to be deposited. Balance due must be deposited by a shortfall make-up date. See IRS Publication 15 for details.</p> <p><b>Deposits on Banking Days Only:</b> If a deposit is required to be made on a day that is not a banking day, the deposit is considered timely made if it is made by the close of the next banking day. In addition to Federal and state bank holidays, Saturday and Sunday are treated as non-banking days.</p> <p><b>Special Rules for Non-banking Days:</b> Semiweekly depositors get at least three banking days following the close of the semiweekly period by which to deposit taxes accumulated during the semiweekly period. For more information, see IRS Publication 15.</p>		

For more information on deposit rules, see IRS Publication 15, *Employer's Tax Guide* (Circular E). For more information on the Electronic Federal Tax Deposit System, see IRS Publication 966.

Penalties, figured as a percentage of the amount due, apply in the following cases:

<b>Deposit</b>	<b>Rate</b>
1-5 days late	2%
6-15 days late	5%
More than 15 days late, but paid by the 10 <sup>th</sup> day after notice and demand. Notice and demand date is the assessment date (23C date).	10%
Taxes still unpaid after the 10 <sup>th</sup> day following notice and demand for payment	15%
Failure to deposit	10%
Amounts subject to electronic deposit but not deposited by EFTPS	10%

## **Wage Reporting**

Form 941 and Form 943 show wages paid and taxes withheld. After the calendar year ends, employers prepare individual employee reports on Forms W-2 (Wage and Tax Statements) with Form W-3 (Transmittal of Wage and Tax Statements), showing the total wages paid and taxes withheld for each employee during the year. This wage information is reported to SSA for crediting to the employees' earnings records—either by sending SSA Copy A of the paper Form W-2 with a covering Form W-3 or by sending the Form W-2 information in the form of electronic or magnetic media reports. Employers who file 250 or more Forms W-2 are required to file returns electronically or use magnetic media.

The information submitted to IRS on Form 941 is compared to the Form W-2 information sent to SSA and any discrepancies must be resolved by the employer. As SSA processes employer wage reports, it maintains a record of total wages processed for each employer. These totals are then compared with IRS employment tax records filed by the employer on Forms 941 or Form 943. Employers whose reports to IRS and to SSA do not match are contacted for an explanation—IRS contacts employers who reported more wages to SSA than to IRS and SSA contacts employers who reported a higher amount to IRS. Failure to resolve these discrepancies may result in IRS assessing penalties for filing incorrect reports.

If an employer needs to talk directly to SSA about an electronic file, magnetic media filing or other wage report processing problem, the employer may contact an Employer Services Liaison Officer (ESLO), listed below, or call 1-800-772-6270 for earnings report technicians' help. Specifications for electronic or magnetic media reporting of Form W-2 information can be found at [www.ssa.gov/employer](http://www.ssa.gov/employer) or by calling the ESLO for your state.

## **Special Situations**

***Information Reporting for Election Workers:*** Compensation of election workers is not subject to income tax withholding. See IRC section 3401(a). If an election worker's

compensation is less than a statutorily established amount (\$1,200 for calendar year 2002), it is generally not subject to social security and Medicare tax. See IRC section 3121(b)(7)(F)(iv) and 3121(u)(2)(B)(ii)(V). However, under a state's 218 Agreement an election worker's compensation may be subject to social security and Medicare taxes at a level below the statutory amount.

If an election worker's compensation is subject to withholding of social security and Medicare tax, Form W-2 reporting is required for all compensation, regardless of the amount. If an election worker's compensation is not subject to withholding of social security and Medicare tax, Form W-2 reporting is required for payments that aggregate \$600 or more in a calendar year. See Revenue Ruling 2000-6, in the Appendix, for further discussion of information reporting with respect to election workers.

**Section 457 (g) Trusts:** A section 457(g) trust, established to hold section 457(b) assets, is not required to file Form 990 (Return of Organization Exempt From Income Tax), Form 1041 (U.S. Income Tax Return for Estates and Trusts), Form 1120, (U.S. Corporation Income Tax Return), or Form 5500 (Annual Return/Report of Employee Benefits Plans). For further information regarding the annual reporting requirements for section 457(g) trusts, annuity contracts or custodial accounts, see Section VI.B of Notice 2000-38 in the Appendix.

### **Worker's Compensation**

Amounts received by police, firefighters, and other employees or their survivors for personal injuries or sickness incurred in the course of employment are excludable from income and social security and Medicare taxes if they are paid under a worker's compensation act or a statute in the nature of a worker's compensation act.

This exclusion does not apply to retirement plan benefits based on age, length of service, or prior contributions to the plan, even if the individual retired because of an occupational sickness or injury.

Worker's compensation benefits are fully excluded from gross income and are not subject to employment taxes, income tax withholding or reporting. Amounts received under a statute "in the nature of" a worker's compensation act, however, may be subject to employment taxes and reporting for the first six months after the employee ceases to work for the employer.

### **Medicare Qualified Government Employment (MQGE)**

Employers must file a separate Form W-2 for each employee subject to Medicare-only withholding. MQGE Forms W-2 are filed separately from Forms W-2 having full FICA wages, or from Forms W-2 having no social security or Medicare wages. Paper MQGE Forms W-2 must be transmitted with a covering Form W-3 with "Medicare Govt. Emp." checked in box b. See the Instructions for Forms W-2 and W-3 or contact your ESLO for more information.

MQGE Forms W-2 records (Code RW records) transmitted by magnetic media or electronically should be grouped to follow a Code RE record with an Employment Code of "Q". All other W-2 records should be grouped to follow a Code RE record with an

Employment Code of "R". Do not group MQGE W-2 records and non-MQGE W-2 records together after a single Code RE record.

### **Employees Covered for MQGE and FICA**

Some state and local employees may be subject to both Medicare-only withholding and full social security and Medicare in the same reporting year. When the employee is in a continuous employment relationship with the same employer (same EIN) for the year, the employer has two reporting options. The employer may:

1. Prepare a single Form W-2 with the total annual wages in box 1, the total Medicare wages and taxes from BOTH positions in box 5 and box 6. Social security and Medicare wages and taxes are entered in box 3 and box 4. (SSA prefers that this method be used to reduce errors), or
2. Use a separate Form W-2 for each withholding category, i.e., one Form W-2 for wage data from the Medicare-only position and a second Form W-2 for FICA wage data from the positions with both social security and Medicare coverage.

### **How SSA Processes Wage Reports**

All wage reports (Form W-2 information) sent to SSA are subject to:

- balancing and validation programs to determine whether the reports are accurate and can be “read” by SSA systems; and
- employee name and social security number (SSN) verification.

Reports that have errors, do not match or do not meet edit conditions are returned to the employer (or submitter) for correction and resubmission.

All employers are subject to IRS **late filing penalty** assessments.

*Note: If the initial report was filed timely and later returned for corrections, the employer will be subject to late filing penalties if the report is not resubmitted on time.*



## Employer Services Liaison Officers

### Region 1

Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont

Don Wilson  
Boston, MA  
(617) 565-2895  
donald.wilson@ssa.gov

### Region 2

New Jersey, New York, Puerto Rico, Virgin Islands

Terry Maresca  
New York, NY  
(212) 264-5643  
terry.maresca@ssa.gov

### Region 3

Delaware, Maryland, Pennsylvania, Virginia, West Virginia

Frank O'Brien  
Philadelphia, PA  
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frank.obrien@ssa.gov

### Region 4

Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, Tennessee

Pat McCarron  
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pat.mccarron@ssa.gov

### Region 5

Illinois, Indiana, Michigan, Minnesota, Ohio, Wisconsin

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### Region 6

Arkansas, Louisiana, New Mexico, Oklahoma, Texas

Bill Bates  
Dallas, TX  
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bill.bates@ssa.gov

### Region 7

Iowa, Kansas, Missouri, Nebraska

John Gezich  
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### Region 8

Colorado, Montana, North Dakota, South Dakota, Utah, Wyoming

Bill Bates  
Denver, CO  
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bill.bates@ssa.gov

### Region 9

Arizona, California, Hawaii, Guam, American Samoa, Nevada, Saipan

Bill Brees  
San Francisco, CA  
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bill.brees@ssa.gov

### Region 10

Alaska, Idaho, Oregon, Washington

Tim Beard  
Seattle, WA  
(206) 615-2125  
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## **Verifying Employee Names and Social Security Numbers**

After wage reports have been entered into SSA's system, each employee name and social security number (SSN) is compared to SSA's records to verify that it is correct. Matched wage reports are updated to the individual employee's record; reports that do not match are identified and the employer or employee is contacted and asked to provide a corrected name or SSN to SSA. Additionally, IRS may impose a penalty of up to \$50 per misreported name and SSN. Accurate crediting of earnings to individual records is essential to the correct payment of social security benefits. Therefore, obtaining a correct name and SSN is very important. See IRS Publication 15, Circular E, section 4, for a discussion of requirements for new hires. SSA offers a free SSN verification service to allow employers to be sure they have a correct name and SSN.

## **Verification Services Available from Social Security**

SSA offers free verification of employee names and social security numbers to employers. This can be done by telephone, paper list, or magnetic media. The instructions are in SSA Publication 20-004, Employee Verification Service (EVS). This is available from any ESLO or it can also be downloaded from SSA's web site at [www.ssa.gov/employer/evs2000](http://www.ssa.gov/employer/evs2000).

**Telephone:** You may call SSA's Employer Services Hotline at 800-772-6270 and verify up to 50 names and SSNs per call. SSA will always verify at least five and may be able (workload permitting) to verify up to 50 items per call. You may also contact SSA at 1-800-772-1213, but only five names per call can be verified at this number.

**Paper List:** You may submit a list of up to 50 items to the local social security office. Write a letter on letterhead and send "Attention: District Manager."

**Larger Requests:** These require registration with SSA's Office of Employer Services. See page 3 of the Employee Verification Service booklet for the address to register and for registration instructions. This allows verification of paper lists of up to three hundred (300) items or an unlimited number of items via Magnetic Media.

**Magnetic Media:** Complete instructions are provided in SSA's Publication 20-004 for submission of either diskette or magnetic tape or cartridge for verification of over 50 items. If you have any questions consult your local ESLO. See table on page 10-19.

## **Verifying Employment Eligibility**

Under the **Immigration and Nationality Act**, employers must verify the identity and employment eligibility of anyone hired for employment in the United States. This includes citizens and non-citizens.

Form I-9, The Employment Eligibility Verification Form, was developed by the Immigration and Naturalization Service (INS) to verify that persons are eligible to work in the United States. Completion of this form is required for every employee hired after November 6, 1986.

The M-274, *Handbook for Employers*, complete with Form I-9 and answers to questions, is available to employers at INS regional and district offices, as well as local government

printing office bookstores. For questions not addressed in the handbook, contact INS at (202) 375-5283 or mail questions to:

U.S. Immigration and Naturalization Service  
Office of Employer and Labor Relations  
425 I Street NW  
Washington DC 20536

A free on-line computer verification service is available to employers in the states of California, Florida, Illinois, Iowa, Nebraska, New Jersey, New York, and Texas. This allows instant verification of name, SSN, and work eligibility via a personal computer and modem. Contact the INS' Business Liaison Office at 888-357-2099 for information and free software for this service.

## **Making Corrections**

Once Form W-2 information has been filed with SSA, any corrections must be made using Form W-2c and Form W-3c.

Forms W-2c may be filed on paper, via electronic transmission, or on magnetic media. Electronic Transmission or magnetic media files should be formatted following the instructions in SSA Publication MMREF-2, Magnetic Media Reporting and Electronic Filing of Forms W-2c, available on SSA's web site at <http://www.ssa.gov/employer/00mmref2.asc> or from any Employer Service Liaison Officer (ESLO), listed in the table above. See "Failure to File Form W-2c and/or Form W-3c with SSA" in Chapter 11 of this publication when adjusting prior year earnings on Form 941 and/or Form 941c.

*Note: There is no requirement to file electronic or magnetic media Forms W-2c regardless of quantity filed.*

If the employee has a name change, the employee must notify SSA and request a new social security card. **Never** change an employee's name in your payroll system until the employee has furnished you a new social security card showing the change. See IRS Publication 15, (*Circular E*), Section 4, for rules on name changes.

Occasionally, a correction to Form W-2 information is required before filing such information with SSA, but after providing the form to the employee. Make changes on a new original form, but annotate it "Reissued Statement" at the top. Be sure to change the information submitted to SSA as well, either by marking the original paper W-2 "VOID" at the top (if you submit on paper) or by correcting the data file before filing either electronically or via magnetic media.

Form W-3c must accompany Copy A of Form W-2c when it is sent to SSA. A separate Form W-3c must be used for each type of Form W-2 being corrected and must accompany a single Form W-2c, as well as multiple Forms W-2c. Large numbers of Forms W-2c may also be filed on magnetic media. Contact your ESLO for details (see page 10-19).

## Common Reporting Errors

### *General*

**Incorrect or missing Employer Identification Number (EIN).** SSA and IRS maintain records by the EIN. Reports received with missing or erroneous EINs may be credited to the wrong record and result in IRS assessing penalties for failure to file correct reports.

**Incorrect employee names and social security numbers.** SSA cannot credit earnings to an employee's record unless the employee's name and social security number on the wage report matches the name and number in the SSA files. Use the name exactly as it is shown on the employee's social security card.

**Wage reports for years after employee's death.** Payments on behalf of a deceased employee made after the year of death cannot be credited as wages for social security purposes. Such payments should be reported to the employee's estate on Form 1099-MISC, **Miscellaneous Income**.

**Errors resulting in out-of-balance reports.** Errors may occur due to incorrect wage base for social security, or applying a wage base limitation to the Medicare wages.

**Tips.** If an employee has tips, they must be reported in the Social Security Tips field (of the W-2). They are **not** included in the social security Wage field. These two fields are added together by SSA to obtain the total social security earnings.

**Omitted wage or tax fields on wage reports.** All fields must be completed.

### *Paper Form W-2 Reports*

**Wrong tax year form used.** SSA optical scanning and imaging systems are modified annually to meet yearly changes in Form W-2 formats. The correct year's W-2 form must be used or SSA (1) will post the earnings to the wrong year, or (2) will be unable to read the form.

**Unscannable reports.** Reports that are not scannable by the SSA's optical equipment are more costly to process and subject to error.

**Failure to file Copy A of Form W-2 with SSA.** Employers must always file Copy A of Form W-2 with SSA, unless they submit the same data electronically or via magnetic media.

**"Void" indicator on Form W-2 checked in error.** SSA will not credit wages shown on any Form W-2 that is void.

### *Electronic/Magnetic Media Reports*

**Failure to file Form 6559 with each magnetic media tape/cartridge.** Form 6559, *Transmitter Report and Summary of Magnetic Media*, must be filed with magnetic media cartridges or tapes to help SSA identify the employer, the type of report and the year being reported before scheduling the report for processing. Multi-reel filers should provide a copy of Form 6559 for each reel.

**Major reporting problems.** Make sure you show the correct tax year on the code RE records. Dollar totals ("RT" Record) are used by SSA to determine whether the report is in balance and, if not, to show where the error may be found. Make sure you report employee names and social security numbers correctly.

**Missing/Incorrect submitter (Code "RA").** This information helps SSA properly identify and control each report. It provides contact information in case there is a problem with the submission.

**Unreadable reports.** Reports must meet the requirements set out in MMREF-1, Magnetic Media Reporting and Electronic Filing, to be processable on SSA's electronic equipment. Unprocessable reports will be returned to the transmitter for correction and returned to SSA. Failure to return the correction reports timely may result in IRS penalty assessment.

*Note: For information on the most recent MMREF-1 formats, visit SSA's website at <http://www.ssa.gov/employer/pub>.*

### **Form 941 Reports.**

**Incorrect or omitted Medicare wage/tip amounts.** Medicare wages/tips must be shown separately from social security wages on Forms 941 filed with the IRS. All Medicare wages/tips are subject to Medicare taxes.

**Showing non-covered amounts as social security and/or Medicare wages.** Examples of non-covered amounts include employee earnings that exceed the wage base for social security and payments to an independent contractor shown as wages.

*See IRS Publication 15 for other noncovered payments under the heading "Special Rules for Various Types of Services and Payments."*

**Failure to file Form W-2c and/or Form W-3c with SSA when adjusting prior year earnings on Form 941 and/or Form 941c.** Adjustments of tax liability filed with IRS that are based on changes in social security and/or Medicare wages must be matched by the filing of Forms W-2c and W-3c with SSA to allow entry of the wage changes on the employee's social security earnings records.

**Filing of duplicate or partially duplicate Forms 941.** Social security and/or Medicare wages shown on duplicate Forms 941 may lead to unnecessary and costly reconciliations between SSA, the IRS and the employer.

## Social Security and Medicare Tax Rates and Limits

Social Security and Medicare Tax				
	1999	2000	2001	2002
<b>Social Security (OASDI) Tax Information</b>				
<b>Employee Rate</b>	6.20%	6.20%	6.20%	6.20%
<b>Employer Rate</b>	6.20%	6.20%	6.20%	6.20%
<b>Maximum Wages*</b>	\$72,600	\$76,200	\$80,400	\$84,900
<b>Medicare Tax Information</b>				
<b>Employee Rate</b>	1.45%	1.45%	1.45%	1.45%
<b>Employer Rate</b>	1.45%	1.45%	1.45%	1.45%
<b>Maximum Wages</b>	<b>All Wages</b>			
<p>*The wage base subject to social security for the next calendar year is calculated and announced by SSA in October. <i>Note: For years after 2002, visit SSA's website at <a href="http://www.ssa.gov/OACT">www.ssa.gov/OACT</a> to obtain the wage base information.</i></p>				

## **Chapter 11**

# **Social Security and Medicare Benefits**

### **Social Security and Medicare Benefits**

Under the Federal Insurance Contributions Act (FICA), social security and Medicare benefits are financed through taxes paid by employees and their employers. The social security and Medicare tax rates are set by law. The tax rate for the Old-Age, Survivors and Disability Insurance (OASDI) program applies to earnings up to an annual maximum amount. This amount, called the earnings base, increases as average wages increase. Medicare Hospital Insurance (HI) taxes are paid on total earnings. There is no wage base limit for Medicare tax. The Supplementary Medical Insurance (SMI) part of Medicare is financed by monthly premiums charged beneficiaries and by payments from Federal general revenues.

### **Earning Credits**

Individuals become eligible for social security benefits and Medicare hospital insurance based on credits for work covered by social security and/or Medicare. (In 2002, one credit is earned for each \$870 in earnings, for up to four quarters.) The amount of earnings required for each credit increases each year to reflect average wage increases.

Credits earned remain on the worker's social security earnings record even if the individual has a period of no earnings. The number of credits needed to be eligible for social security and Medicare benefits depends on the individual's age and the type of benefit. Most people need 40 credits (10 years of work) to qualify for benefits. Younger people need fewer credits to be eligible for disability benefits or for their family members to be eligible for survivors' benefits if they die.

State and local government employees covered for Medicare HI-only must earn the same number of credits to qualify for Medicare as required for social security benefits. Basic pay earned from active military duty or training in the military service beginning in 1957 may earn social security credits. In addition, military service before 1957 may qualify a person for additional earnings credits. Determination of these additional credits is made at the time a person applies for benefits.

If a question arises concerning the employment relationship of a worker for claims purposes, SSA determines whether there was a common-law employer-employee relationship for the purpose of determining the benefits of the claimant.

### **Retirement**

Retirement benefits are payable at full retirement age (with reduced benefits available as early as 62) to individuals with 40 credits (10 years of work). Beginning in the year 2003,

the age at which full benefits are payable will increase in gradual steps from 65 to 67. This provision affects people born in 1938 and later.

If you receive social security benefits before you reach full retirement age, your benefits are reduced if you continue to work and earn over an annual exempt amount. The annual exempt amount changes each year. You can earn up to that amount and still receive all of your social security benefits. If you are under full retirement age and earn over the exempt amount, your benefits will be reduced \$1 for every \$2 in earnings above the exempt amount. In the year you reach full retirement age your benefits will be reduced \$1 for every \$3 in earnings above the exempt amount.

A spouse or former spouse may qualify for benefits upon a worker's retirement or disability. (Note: Benefits for divorced spouses age 62 or older may be payable if the insured worker is "eligible" for retirement benefits, even though not yet retired.) Benefits are paid as early as age 62 or at any age if the spouse is caring for the worker's child. The child must be under 16 or disabled and receive benefits on the worker's record. Spouse's benefits will be one-half or less of "full retirement age" monthly benefit.

Unmarried children under the age of 18 (under 19 if in high school) or any age if disabled before age 22 may qualify for social security benefits on a retired or disabled parent's social security record.

### **Social Security Benefits**

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
<b>Earnings required for one credit</b>	<b>\$740</b>	<b>\$780</b>	<b>\$830</b>	<b>\$870</b>
<b>Exempt amounts under annual earnings test:</b>				
<b>Under full retirement age</b>	<b>\$9,600</b>	<b>\$10,080</b>	<b>\$10,680</b>	<b>\$11,280</b>
<b>Year of Attainment of full retirement age</b>	<b>\$15,500</b>	<b>\$17,000</b>	<b>\$25,000</b>	<b>\$30,000</b>
<b>Full retirement age or older</b>	<b>No limits effective January 2000.</b>			

***NOTE:** For years after 2002, visit the Social Security Administration's website at [www.ssa.gov/OACT](http://www.ssa.gov/OACT) to obtain new Social Security benefit amounts.*

### **Survivors**

For family members to receive benefits upon a worker's death, the worker must have earned one social security credit for each year beginning in 1951 (or since age 21, which ever is later) and a minimum of six credits. Family members may also qualify for benefits if the worker earned six credits in the three years prior to death. The number of credits a person needs for survivors to be eligible for benefits increases each year until the worker reaches age 62, up to a maximum of 40 credits.



Children and the surviving spouse may qualify for monthly benefits up to a maximum level and may also qualify for a one-time death benefit. A surviving spouse's benefit can be affected by his or her age, work history, and the number of other family members who receive benefits on the deceased worker's earnings record. The benefit is permanently reduced if the surviving spouse retires before age 65 and is not caring for a child who receives benefits on the deceased worker's earnings record.

Benefits are paid to widows and widowers at age 60, at age 50 if disabled, or at any age if the widow or widower is caring for the deceased's child. The child must be under age 16 or disabled before age 21 and eligible to receive benefits on the deceased's record.

Unmarried children under the age of 18 (under 19 if in high school) or any age if disabled before age 22 also may qualify for social security benefits on a deceased parent's social security record.

### **Disability**

To qualify for disability benefits, a worker must be fully insured and, except where the individual is disabled because of blindness, must also meet a test of substantial recent work activity. Under this test, a worker aged 31 or older must have at least 20 credits during the period of 40 calendar quarters ending with the quarter in which the disability began. Workers disabled at ages 24 through 30 must have credit in one-half of the calendar quarters elapsing after age 21, and workers under age 24 need 6 credits in the period of 12 quarters ending with the quarter of disability onset.

Benefits to the worker and entitled family members may be reduced if workers' compensation or public disability benefits are also received.

### **Medicare Hospital Insurance (HI)**

The Medicare program is administered by the Centers for Medicare & Medicaid Services (CMS), formerly known as the Health Care Financing Administration. However, SSA enrolls people in the program and disseminates general Medicare information. Individuals who are eligible for social security are eligible for premium-free hospital insurance (HI) benefits when they reach age 65. In addition, workers and their spouses with a sufficient period of Medicare-only coverage in Federal, state and local government employment are eligible at age 65. HI provides protection to disabled beneficiaries who have been entitled to social security disability benefits for at least 24 months (or government employees with Medicare-only coverage who have been disabled for more than 29 months), and to insured workers (and their spouses and children) with chronic kidney disease that requires dialysis or a kidney transplant. Effective July 1, 2000, the 24-month waiting period is waived for disability beneficiaries who have Amyotrophic Lateral Sclerosis. Call 1-800-MEDICARE to speak with a Medicare Customer Representative.

**Note:** Although the full retirement age for social security is changing, Medicare eligibility remains at age 65. Eligibility for HI is based on benefits as a retired worker, as a spouse of a retired or disabled worker or as a spouse of a deceased worker. The

individual qualifies even if the individual does not receive monthly social security retirement benefits because the individual or the individual's spouse continues to work.

Special rules apply to uninsured persons who are at least 65 but who are not eligible for HI under the regular rules. See Chapter 5, **Medicare Coverage**.

## **Social Security Statement**

SSA sends a statement annually to workers and former workers aged 25 and older that have paid social security taxes during their working years. This statement shows all earnings on which a worker has paid social security taxes during his/her working years. Workers at any age may request a benefit estimate by completing Form SSA-7004 (Request for Social Security Statement). These requests should be made by calling 1-800-772-1213 or through the SSA web site at [www.ssa.gov/mystatement](http://www.ssa.gov/mystatement). The statements should be examined closely by the employee to ensure all earnings are properly credited. If the earnings shown on the statement are not correct, the employee should call SSA at 1-800-772-1213.

**Note:** Individuals who have worked only in non-covered employment (no social security and Medicare taxes) for their entire working lifetimes will not receive a Social Security Statement.

The Medicare portion of the Social Security Statement reflects the amount of earnings that were taxed and an estimate of the amount of taxes paid to support the Medicare program. The taxes are estimated because SSA does not keep records of Medicare taxes paid. If an employee had both social security earnings and government earnings that qualified for Medicare in the same year, the statement would reflect an estimate of the combined Medicare taxes paid. Online benefit planners are available at [www.ssa.gov/planners](http://www.ssa.gov/planners). These can be used to project potential benefits using various earnings scenarios.

## **Pensions from Work not Covered by Social Security**

There are two situations where receipt of a pension based on employment not covered by social security will affect the amount of your social security benefit. The Windfall Elimination Provision (WEP) affects the way your social security retirement or disability benefit is computed. The Government Pension Offset (GPO) affects the amount of the social security benefit you receive as a spouse or widow (er). SSA Publication 05-10045 covering WEP and SSA Publication 05-10007 covering GPO are available from the Social Security Administration by calling 1-800-772-1213. These publications can also be downloaded from the SSA Publications web page at [www.ssa.gov/about](http://www.ssa.gov/about). Employers assisting in retirement planning are urged to provide copies of these publications to their employees.

### **Windfall Elimination Provision (WEP)**

If you receive a pension based on work not covered by social security, your social security retirement or disability benefit is computed using a modified benefit formula.

The resulting benefit amount is lower than you would receive if you did not also receive a pension based on noncovered employment.

The purpose of WEP is to remove the unintended advantage that the heavy weighting in the social security benefit formula provides for persons who receive pensions from noncovered employment. The weighting is intended to help people who spend their working lives in low paying jobs by providing them with a benefit that is higher in relation to their prior earnings than the benefit provided for workers with high career earnings.

However, the formula also benefits people who worked for only a portion of their careers in jobs covered by social security but had their benefits computed as if they were long-term, low-wage workers. WEP eliminated this advantage by providing for a different, less heavily weighted benefit formula used to compute benefits for persons who receive a pension based on non-covered employment.

The modified formula applies to those who reach age 62 or become disabled after 1985 and first become eligible after 1985 for a monthly pension based in whole or in part on work not covered by social security. You are considered eligible to receive a pension if you meet the requirements of the pension, even if you continue to work.

Workers with relatively low pensions are protected because the reduction in the social security benefit cannot be more than one-half of that part of the pension attributable to earnings not covered by social security.

The modified formula does not apply to survivor benefits. It also does not apply to:

- A Federal worker performing service on January 1, 1984, who becomes newly covered under social security on January 1, 1984 under the mandatory coverage provision in PL 98-21;
- An employee of a non-profit organization who is exempt from social security coverage on December 31, 1983, and who becomes covered for the first time as an employee of that organization on January 1, 1984 under the compulsory coverage provision of PL 98-21;
- Pensions based on earnings under the Railroad Retirement Act;
- Pensions based entirely on noncovered employment before 1957; or
- Persons who have 30 or more years of substantial earnings under social security.

### **Government Pension Offset (GPO)**

The Government Pension Offset (GPO) applies only to workers who get a government pension and are eligible for social security as a spouse or widow (er). Two-thirds of the government pension is used to offset any spouse's or widow(er)'s social security benefit.

Before the offset provisions were enacted, many government employees qualified for a pension from their agency and for a spouse's benefit from social security, even though they were not dependent on their husbands or wives.

This was considered unfair because those who receive a spouse's or widow(er)'s benefit and are not government employees already were subject to a similar offset that affects their benefits. For example, a woman eligible for \$400 in social security retirement benefits on her own work record, and also eligible for a wife's benefit of \$300 receives only the higher of the two benefits - \$400 in this case.

The Government Pension Offset does not apply if on the spouse's last day of state/local employment, he/she is in a position that was covered by social security and the pension plan. This rule applies even if the employment:

- terminates but the employee returns to work for the same or different employer; or
- is not terminated, but the employee transfers to a different position for the same employer; or
- is not terminated, but the employee takes a second job for the same employer.

Options provided by certain deferred compensation plans may allow state and local government employees to make decisions that would allow them to meet the criteria for this GPO exemption. A state or local entity may maintain an elective defined contribution plan that allows employees to change their contribution election during the year, including moving in or out of the plan. Further, one plan may provide one or more open seasons when the participants may change their elections to participate or change the amount of contribution.

Another plan may allow participants to "revoke" an election to defer amounts to the plan at any time during the year. When the employee decides not to participate in the plan, the plan administrator must determine whether the employee is (1) still a participant of the plan based on IRS regulations and (2) covered for social security mandatorily or by a Section 218 agreement.

A statement from the employer or pension-paying agency showing the employee was in a position on the last day of employment that was covered under social security AND also covered by the pension plan is acceptable evidence to show the GPO exemption is met. SSA generally accepts the employer's statement at face value when making the determination that the GPO exemption is met.

### **Defining a Pension for WEP/GPO Purposes**

Since 1991, state and local government employees who are not members of a retirement system must be covered by social security. This provision, called mandatory social security, does not apply if the employee already has social security coverage under an Agreement under Section 218 of the Social Security Act. Mandatory social security coverage may cease if the employee becomes a qualified participant in a public retirement system that satisfies the criteria in IRC section 3121(b)(7) and regulations.

In lieu of social security, some public employers have opted for alternative retirement plans instead of a conventional pension plan, for instance a deferred compensation plan. This and other alternative plans raise questions about the applicability of WEP and GPO.

A plan is considered a savings plan and is not a pension for WEP/GPO purposes if:

- An employee voluntarily contributes to a plan that is separate from and in addition to a primary retirement plan;
- The employer makes no contributions to the plan;
- The withdrawals from the plan do not exceed the employee's contributions (plus interest); and
- Withdrawals are not based upon age, length of service or earnings.

*Examples:*

1. A part-time employee for a city is not covered by a 218 Agreement. In July 1991, the employee elected to participate in the state's public employees deferred compensation plan in lieu of mandatory social security coverage. The employee, upon retirement, will receive a payment from the deferred compensation plan based on employee and employer contributions to the plan, as this is the only plan to which the employee contributes. This plan is not considered a savings plan for GPO or WEP purposes and the payment will be considered a pension and subject to the GPO or WEP provisions.
2. A state employee is not covered by a 218 Agreement, but is covered by a state employee retirement system and has also elected to make contributions to a deferred compensation plan. The payment from this deferred compensation plan is separate from and in addition to the primary retirement plan. The employer made no contributions to the deferred compensation plan and the payment from the deferred compensation plan is not based on age, length of service or earnings. While the payment from the retirement system is subject to GPO or WEP, the payment from the deferred compensation plan is not.

## **QUESTIONS AND ANSWERS**

1. **Are social security benefits calculated on the last five years of earnings?** No. Retirement benefits are calculated on earnings during a lifetime of work, generally the highest-earning 35 years under the social security system. Years of high earnings will increase the amount of the benefit. [SSA]

2. **Will my retirement pension from my government job reduce the amount of my social security benefit?** If you receive a pension based on employment covered under social security, it will not affect your social security benefit. If you receive a pension either wholly or partially based on employment not covered under social security (for example, certain Federal, state or local government employment), your social security benefit may be reduced. For additional information, see SSA publications “Government Pension Offset” (05-10007) and “A Pension for Work Not Covered by Social Security” (05-10045). These publications are available online at [www.ssa.gov](http://www.ssa.gov). [SSA]
3. **I understand I can retire at age 62 and collect social security benefits, but that they will be less than if I wait until 65 to retire. How does that work?** Your benefits are reduced for each month you retire before full retirement age. The reduction is five ninths of one percent for each of the first thirty-six months of early retirement and five twelfths of one percent for each additional month. However, remember, by taking benefits at age 62, you’ll receive social security checks for a longer period of time. [SSA]
4. **I have two children at home and I plan to retire next fall. Will my children be eligible for monthly social security checks after I retire?** Monthly social security payments may be made to unmarried children under age 18, or age 19 if still in high school, or children age 18 or over who were severely disabled before age 22 and who continue to be disabled. [SSA]

## Chapter 12

# Publications, Forms and Other Resources

### Publications and Forms — Internal Revenue Service

Actual exhibits are not included in this chapter because forms are revised frequently. A more comprehensive list of IRS publications is available in IRS Publication 17, **Your Federal Income Tax (For Individuals)**.

<b>Publication Number</b>	<b>Title</b>
1	Your Rights as a Taxpayer
15	Circular E, Employer's Tax Guide
15-A	Employer's Supplemental Tax Guide
15-B	Employer's Tax Guide to Fringe Benefits
17	Your Federal Income Tax (For Individuals)
51	Circular A, Agricultural Employer's Tax Guide
80	Circular SS, Federal Tax Guide for Employers in the Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands
393	Federal Employment Tax Forms
463	Travel, Entertainment, Gift and Car Expenses
508	Tax Benefits for Work-Related Education
509	Tax Calendars for 2002 ( <i>title revised annually</i> )
515	Withholding of Tax on Nonresident Aliens and Foreign Corporations
516	U.S. Government Civilian Employees Stationed Abroad
517	Social Security and Other Information for Members of the Clergy and Religious Workers
519	U.S. Tax Guide for Aliens
520	Scholarships and Fellowships
521	Moving Expenses
525	Taxable and Nontaxable Income

<b>Publication Number</b>	<b>Title</b>
<b>553</b>	Highlights of 2001 Tax Changes <i>(title revised annually)</i>
<b>571</b>	Tax-Sheltered Annuity Plans for Employees of Public Schools and Certain Tax-Exempt Organizations
<b>575</b>	Pension and Annuity Income
<b>590</b>	Individual Retirement Arrangements (IRAs)
<b>594</b>	What You Should Know About the IRS Collection Process
<b>596</b>	Earned Income Credit (EIC)
<b>721</b>	Tax Guide to U.S. Civil Service Retirement Benefits
<b>901</b>	U.S. Tax Treaties
<b>910</b>	Guide to Free Tax Services
<b>915</b>	Social Security and Equivalent Railroad Retirement Benefits
<b>926</b>	Household Employer's Tax Guide
<b>939</b>	General Rule for Pensions and Annuities
<b>947</b>	Practice Before the IRS and Power of Attorney
<b>957</b>	Reporting Back Pay and Special Wage Payments to the Social Security Administration
<b>1542</b>	Per Diem Rates
<b>1976</b>	Independent Contractor or Employee?
<b>SS-4</b>	Application for Employer Identification Number
<b>SS-8</b>	Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding
<b>W-2</b>	Wage and Tax Statement
<b>W-2c</b>	Corrected Wage and Tax Statement
<b>W-3</b>	Transmittal of Wage and Tax Statements
<b>W-3c</b>	Transmittal of Corrected Wage and Tax Statements
<b>W-4</b>	Employee's Withholding Allowance Certificate
<b>W-5</b>	Earned Income Credit Advance Payment Certificate
<b>W-9</b>	Request for Taxpayer Identification Number and Certification



<b>Form Number</b>	<b>Title</b>
<b>941</b>	Employer's Quarterly Federal Tax Return
<b>941c</b>	Supporting Statement To Correct Information
<b>943</b>	Employer's Annual Tax Return For Agricultural Employees
<b>945</b>	Annual Return Of Withheld Federal Income Tax
<b>945-A</b>	Annual Record Of Federal Tax Liability
<b>1042</b>	Annual Withholding Tax Return for U.S. Source Income of Foreign Persons
<b>1042-S</b>	Foreign Person's U.S. Source Income Subject to Withholding
<b>1096</b>	Annual Summary and Transmittal of U.S. Information Returns
<b>1099-MISC</b>	Miscellaneous Income
<b>8233</b>	Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual

You can download most IRS forms and publications from the IRS web site, [www.irs.gov](http://www.irs.gov). To order by phone, call 1-800-829-3676 (toll-free). To request forms by fax, call 1-703-368-9694 from your fax machine. Forms and publications are also available at IRS walk-in offices.

The IRS also offers the following free of charge. Visit [www.irs.gov](http://www.irs.gov) for more information.

- ◆ Forms and Publications on CD-ROM
- ◆ IRS press releases and fact sheets
- ◆ TeleTax topics on about 150 tax topics (1-800-829-3676)
- ◆ Educational Materials
- ◆ Telephone assistance (1-800-829-1040)

## Publications and Forms – Social Security Administration

Publication/Form Number	Title
SS-5	Application for Social Security Number
SSA-7004	Request for Social Security Statement
16-004	Employer's Guide to Filing Timely and Accurate W-2 Wage Reports
20-004	Employee Verification Service (EVS) (Contains instructions for using SSA's Enumeration Verification System (EVS) to match names and social security numbers with SSA's records.)
20-007	Online Wage Reporting Service
31-011	Software Specifications and Edits for Annual Wage Reporting
31-031	Software Specifications and Edits for Correcting Annual Wage Reports
MMREF-1 and MMREF-2	Magnetic media reporting and electronic filing instructions for Form W-2 and Form W-2c data
---	<i>SSA/IRS Reporter</i> (A newsletter that keeps employers informed of the latest wage and tax reporting news. It is free and mailed quarterly with IRS Form 941 (Employer's Quarterly Federal Tax Return). To obtain a copy, call IRS toll-free at 1-800-829-FORM.)

To request SSA publications:

- ◆ Telephone 1-800-772-1213 (toll-free), or TTY 1-800-325-0778
- ◆ Download from the SSA web site at [www.ssa.gov/employer](http://www.ssa.gov/employer).

### Other SSA Services

#### Online Wage Reporting System (OWRS)

Employers with Internet access can submit their W-2 file using SSA's Online Wage Reporting Service at [www.ssa.gov/employer](http://www.ssa.gov/employer). This option is fast, free and secure and uses the same W-2 file format as would be sent on disk or tape. For security, a PIN and a password are required before you submit your W-2 file over this web page; most registrations can be completed on the web page. For more information, visit [www.ssa.gov/employer](http://www.ssa.gov/employer) or call your ESLO (see list in Chapter 10).

## **SSA Speaker's Bureau**

SSA can arrange to have speakers available for wage reporting seminars, pre-retirement sessions and other employer-sponsored onsite meetings with employees to discuss social security matters. For more information, contact any Social Security office or call 1-800-772-1213. For a local SSA office near you, see [www.ssa.gov/reach](http://www.ssa.gov/reach).

## **Statistical Information**

SSA's Office of Research, Evaluation and Statistics (ORES) provides ongoing statistical data and research analyses of the Old-Age, Survivors, and Disability Insurance (OASDI) and Supplemental Security Income (SSI) programs. In quarterly, annual and one-time publications, ORES keeps current on major issues that historically or currently have policy implications and program relevance for the nation's major income security programs.

ORES has a number of its publications and tables available online at its website address <http://ssa.gov/statistics/orespubs>. Publications may also be requested by calling 1-202-282-7138, by faxing ORES at 1-202-282-7219 or by writing to ORES Publications Staff, Room 209 Van Ness Center, 4301 Connecticut Avenue, NW, Washington, DC 20008.

## **SSA Web Sites**

### ***Employer Reporting Instructions and Information ([www.ssa.gov/employer/](http://www.ssa.gov/employer/))***

This SSA web site addresses employer reporting and other interests.

### ***Social Security Online ([www.ssa.gov](http://www.ssa.gov))***

SSA's home page that lists available online services such as benefit planners, Social Security Statements, Medicare card replacement, etc.

### ***State and Local Government Employers ([www.ssa.gov/slge/](http://www.ssa.gov/slge/))***

This site is for state and local government employers who are responsible for withholding, reporting and paying Social Security and Medicare taxes for public employees.

## **Employer Training Seminars**

Each year, Employer Service Liaison Officers (ESLOs) provide a series of free training seminars to annual wage reporters. Call your local ESLO to find out when a seminar is held in your area. Or check our web site at [www.ssa.gov/employer/sem](http://www.ssa.gov/employer/sem) for a list of seminars held around the nation.



## Chapter 13

# Glossary

**Absolute Coverage Group** – For Section 218 coverage purposes, a group of employees whose positions are not covered under a retirement system; also referred to as a non-retirement system coverage group or a Section 218(b)(5) coverage group.

**Agreement** - Section 218 Agreement.

**Alternative Lookback Rule** – A rule that allows an employer to determine whether an employee can be treated as a qualified participant in a retirement plan for purposes of mandatory FICA. An employer may treat an employee as a qualified participant in the first year of employment if it is reasonable to believe the employee will be a qualified participant on the last day of the plan year. An employer may treat an employee as a qualified participant in a calendar year if the employee was a qualified participant at the end of the previous plan year. See Section 31.3121(b)(7)-2(d)(3), Employment Tax Regulations.

**Annual Wages Paid** - The sum of wages paid over the calendar year.

**Average Annual Employment** - The average employment for the 12 reporting months of the calendar year.

**Average Annual Wage** - The annual wages paid divided by the average annual days of employment.

**Continuing Employment Exception** – Exception from Medicare taxes and coverage applicable to services of a state or local government employee who is a participant in a public retirement system and meets all of the following requirements:

- Employee was performing regular and substantial services for remuneration for the employer before April 1, 1986;
- Employee was a bona fide employee on March 31, 1986;
- Employment relationship was not entered into for purposes of avoiding the Medicare tax; and
- Employment relationship with the employer has not been terminated after March 31, 1986.

**Coverage Groups** – Categories of state and local government employees brought under a Section 218 Agreement. There are two types of coverage groups:

1. Absolute coverage groups, composed of employees in positions not covered under a retirement system; and
2. Retirement system coverage groups, composed of employees in positions covered by a retirement system.

The *Social Security Act* gives each state the right, within the limits of state and Federal laws, to decide which coverage groups are to be included under its Agreement and any modifications to the Agreement.

**Department of Health and Human Services (DHHS)** – Former parent agency of SSA responsible for Section 218 Agreements. Prior to March 31, 1995, Section 218 Agreements were entered into between a state and the Department of Health and Human Services and administered by the Social Security Administration. Since that date, SSA has been an independent agency and is responsible for executing and administering Section 218 Agreements with the states.

**Defined Benefit Plan** - A plan that determines retirement benefits under a formula, generally based on age, years of service and salary level.

**Defined Contribution Plan** - A plan that provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains, losses and forfeitures of accounts of other participants that may be allocated to the participant's account.

**Earned Income Credit (EIC)** - A tax credit for workers who have earned income below specific thresholds.

**Earnings Record** - The information maintained by the Social Security Administration on each individual's social security and Medicare covered wages and self-employment income. Each individual's record is accessed by Social Security Number (SSN).

**EIC** - Earned income credit (see above).

**EIN** - Employer identification number.

**Employee** - Generally a common-law employee. Defined for social security and Medicare purposes in Sections 210(j)(2) and 218(b)(3) of the *Social Security Act* and IRC section 3121(d).

**Employer Identification Number (EIN)** – A unique nine-digit identification number assigned by IRS to state and local governments, businesses, and other entities for tax-filing and reporting purposes, including withholding and paying FICA taxes. An entity can obtain an EIN by filing Form SS-4, Application For Employer Identification Number, with the IRS.

**Entity** – A separate legal “person,” that is not an individual; a corporation, partnership, LLC, a political unit, including a state, a political subdivision, a wholly-owned instrumentality, a municipality, etc.

**Establishment** - An establishment is an economic unit, generally at a single physical location, where business is conducted or where services or industrial operations are performed.

**Federal Insurance Contributions Act (FICA)** – Federal statute imposing social security and Medicare taxes on employers and employees with respect to wages for employment.

**Federal-State Agreement** – Formal arrangement available beginning in 1951, when states were allowed to provide social security and/or Medicare coverage to employees of states or their political subdivisions by means of an agreement between the Federal government and the state, governed by Section 218 of the *Social Security Act*.

**Federal Unemployment Tax Act (FUTA)** – Federal law imposing Unemployment Insurance (UI) tax on employers to aid workers who lose their job through no fault of their own. States and political subdivisions of a state are exempt from paying FUTA, but most state and local government employees must be covered for state unemployment insurance purposes. This agreement is commonly referred to as a Section 218 Agreement.

**Fee-Based Public Official** – A public official who receives and retains remuneration directly from members of the public, e.g., a notary public. An official who receives payment for services from government funds in the form of a wage or salary is not a fee-based public official, even if the compensation is called a fee.

**FICA** - Federal Insurance Contributions Act.

**FRA (Full Retirement Age)** – The age at which unreduced social security benefits are payable. Depending on the date of birth, an individual’s FRA is between 65 and 67.

**Full Social Security** - Full social security includes both the Old-Age, Survivors, and Disability Insurance (OASDI) program and Medicare Hospital Insurance (HI). Both the employer and employee pay these taxes.

**FUTA** - Federal Unemployment Tax Act.

**Governmental Function** - A traditional function of government, legislative, executive, judicial: the control and prevention of crime, promoting the general welfare, providing for public safety.

**Government Pension Offset (GPO)** – A reduction in the social security benefits that applies to individuals who (1) receive a government pension not covered for Social Security and (2) who are eligible for social security as a spouse or widow(er). Two-thirds of the government pension is used to offset any spouse’s or widow(er)’s social security benefit.

**Gross Wages** - As reported on the Unemployment Insurance Tax Report, gross wages are the total amount of compensation paid by employers for the year.

**HI** - Hospital Insurance (Medicare Part A).

**Identification Number** – A nine-digit number assigned by SSA prior to 1987 to every state and political subdivision included under a Section 218 Agreement, beginning with the prefix “69” (69-NNNNNNN). Many states continue to sequentially assign a 69-number to entities brought under Section 218 coverage for internal state record keeping purposes.

**Indian Tribal Government** – The governing body of any tribe, band, community, village or group of Indians or (if applicable) Alaska Natives that is determined by the Secretary of the Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions. IRC section 7701(a)(40). Under IRC section 7871(a), listing purposes for which Indian tribal governments are treated as states, a subdivision of an Indian tribal government shall be treated as a political subdivision of a state if (and only if) the Secretary of the Treasury determines, after consultation with the Secretary of the Interior, that the subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.

**Indian Tribe** – For purposes of the FUTA tax, includes any subdivision, subsidiary, or business enterprise wholly owned by an Indian tribe. IRC section 3306(u).

**Ineligibles** - Individuals who work in retirement system positions but are not eligible for membership in the retirement system because of a personal disqualification such as age or length of service.

**Interstate Instrumentality** - An independent legal entity organized by two or more states to carry out one or more governmental functions. For purposes of a Section 218 Agreement, an interstate instrumentality has the status of a state.

**IRC** - Internal Revenue Code.

**IRS** - Internal Revenue Service.

**IRS Letter Ruling/Determination** - Procedure for obtaining a binding ruling from the IRS, applying the law to specific facts on a variety of issues including worker classification, wages, employment, etc. By law, there may be a fee for certain rulings. (Contact the IRS for further information.)

**Mandatory Exclusions** - Those services that are not covered under Sections 210 and 218 of the Social Security Act.

**Mandatory Medicare (HI)** – Required application of Medicare tax and coverage to state and local government employees hired or rehired after March 31, 1986.

**Mandatory Social Security** – Required application of social security tax and coverage to state and local government employees who are not members of a public retirement system and who are not covered by a Section 218 Agreement; effective July 2, 1991.

**Medicare** – Health insurance program for people age 65 years of age and older and certain people with disabilities. Part A (Hospital Insurance – HI) is financed through employer and employee taxes on covered wages/self-employment or by individual payment of monthly premiums. Part B (Supplemental Medical Insurance – SMI) is financed by individuals paying monthly premiums.

**Medicare Qualified Government Employment (MQGE)** – Services of state and local government employees subject to Medicare (HI only) tax but not to social security tax.



**Modification** – An amendment to an original Section 218 Agreement to extend coverage to additional groups of employees or to implement changes in Federal and state laws. Each modification, like the original Agreement, is a legally binding document.

**MQGE** - Medicare Qualified Government Employment.

**National Conference of State Social Security Administrators (NCSSSA)** – Professional association of State Social Security Administrators, state officials authorized by state law to administer Section 218 Agreements with the Social Security Administration and responsible for all other activities associated with Federal and state laws addressing social security and Medicare coverage of state and local public employers.

**NCSSSA** - National Conference of State Social Security Administrators.

**Non-covered Employment** - Employment not covered by social security or Medicare under the Social Security Act and the Internal Revenue Code.

**Non-Proprietary Function** – Governmental function of a state or political subdivision, i.e., maintaining order.

**OASDI** – Old-Age, Survivors and Disability Insurance Program.

**Old-Age, Survivors and Disability Insurance Program (OASDI)** – Program administered by the Social Security Administration, providing monthly benefits to retired and disabled workers, their spouses and children, and to survivors of insured workers.

**Optional Exclusions** - Those services that Federal law gives states the option to include or exclude from coverage under a Section 218 Agreement.

**Parallel Social Security Office (PSSO)** - The SSA office, usually located in the state capital, responsible for day-to-day negotiations with the states on state and local coverage issues.

**Pension Plan** – A plan that provides systematically for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. Retirement benefits are generally determined by factors such as an employee’s years of service and compensation.

**Political Subdivision** – A separate legal entity of a state that has governmental powers and functions. A political subdivision ordinarily includes a county, city, town, village, school district and other similar governmental entities.

**Proprietary Function** - Function of a governmental entity that is other than governmental in nature.

**PSSO** - Parallel Social Security Office.

**Public Retirement System** - A pension, annuity, retirement, or similar fund or system established by a state or political subdivision for the purpose of paying retirement benefits to employees. For purposes of determining whether an employee is subject to mandatory social security and Medicare, a “retirement system” in which the employee participates must meet the tests under IRC section 3121(b)(7)(F) and section

31.3121(b)(7)-2(e) of the Employment Tax Regulations. For this purpose a “retirement system” is not identical to a qualified plan within the meaning of the Employees’ Retirement Income Security Act of 1974 (ERISA).

**Qualified Participant** – An individual who is (or has been) an actual participant in a public retirement system and who has a total accrued benefit under the retirement system that meets the minimum retirement benefit requirements of IRC section 3121(b)(7) and regulations thereunder. Section 31.3121(b)(7)-2(d) of the Employment Tax Regulations establishes standards for defined contribution retirement systems. See Rev. Proc. 91-40 in the Appendix, for safe-harbor formulas for defined benefit retirement systems.

**Retirement System** - See Public Retirement System.

**Retirement System Coverage Group** – A group of employees whose positions are covered under a retirement system by referendum under the provisions of Section 218(d). The retirement system does not need to meet the tests under IRC Section 3121(b)(7)(F) and Section 31.3121(b)(7)-2(e) of the Employment Tax Regulations to secure coverage under an Agreement.

**SECA** - Self Employment Contributions Act.

**Section 218 Agreement** - Voluntary agreement between a state and the Commissioner of Social Security (prior to March 31, 1995, the Secretary of Health and Human Services); allows states to voluntarily provide social security and Medicare or Medicare-only coverage for the services of state and local government employees. The agreements cover positions, not individuals, so that, if the position is covered under the agreement, then any employee filling that position is subject to FICA taxes.

**Self-Employment Contributions Act (SECA)** - Federal statute imposing social security and Medicare taxes on self-employed individuals.

**Social Security Act (Act)** - Federal statute providing Old-Age, Survivors and Disability Insurance (OASDI) and Hospital Insurance (Medicare), as well as other benefits.

**Social Security Administration (SSA)** - An independent agency in the executive branch of the Federal government responsible for administering the Old-Age, Survivors and Disability (OASDI) insurance program and for determining eligibility for Medicare benefits.

**Social Security Statement** – Annual statement issued to workers with information about their individual social security and Medicare earnings as reported by employers with estimates of the different types of benefits for which they and their family may qualify.

**State Social Security Administrator (SSSA)** - The principal state official authorized by state law to administer the Section 218 Agreement with the Social Security Administration and responsible for all other activities associated with applicable Federal and state laws addressing social security and Medicare by state and local public employers in the state.

**Social Security Number (SSN)** - The identification number assigned by the Social Security Administration to individuals. It must always be used in reporting an individual's earnings and in correspondence regarding specific employees. Each individual's earnings record is maintained under this number.

**Social Security Offices** - The offices that administer the social security program locally. These servicing offices may request technical assistance from the PSSO as needed.

**SSA** - Social Security Administration.

**State** - For purposes of a Section 218 Agreement includes the fifty states, Puerto Rico, the Virgin Islands and interstate instrumentalities. It does not include the District of Columbia, Guam or American Samoa.

**Taxpayer Identification Number TIN** - The number used to identify employee (SSN) or employer (EIN) for tax reporting purposes.

**Ticket to Work and Self-Sufficiency Program** - An SSA program that provides disabled beneficiaries expanded access to employment services, vocational rehabilitation services, or other support services. SSA pays the providers of those services after the beneficiaries achieve certain levels of work.

**TIN** - Taxpayer identification number.

**Wage Base** - The maximum wage of each worker that is subject to the OASDI portion of social security tax in any calendar year. The social security wage base changes yearly. There is no wage base limit for Medicare beginning in 1994.

**Wages** - Remuneration paid in cash or some other form for services of an employee.

**Wholly Owned Instrumentality** - An entity created by or pursuant to state statute to carry on a governmental function of a state or political subdivision. It is an independent legal entity with the power to hire, supervise, and discharge its employees and, generally, it may sue and be sued, may enter into contracts, and may hold or transfer property in its own name. Normally a wholly owned instrumentality of a state or political subdivision does not exercise governmental powers, i.e., the police power, the taxing power and the power of eminent domain. An instrumentality can also be created by a state and a political subdivision, by more than one political subdivision, or by more than one state. See "Interstate Instrumentality."

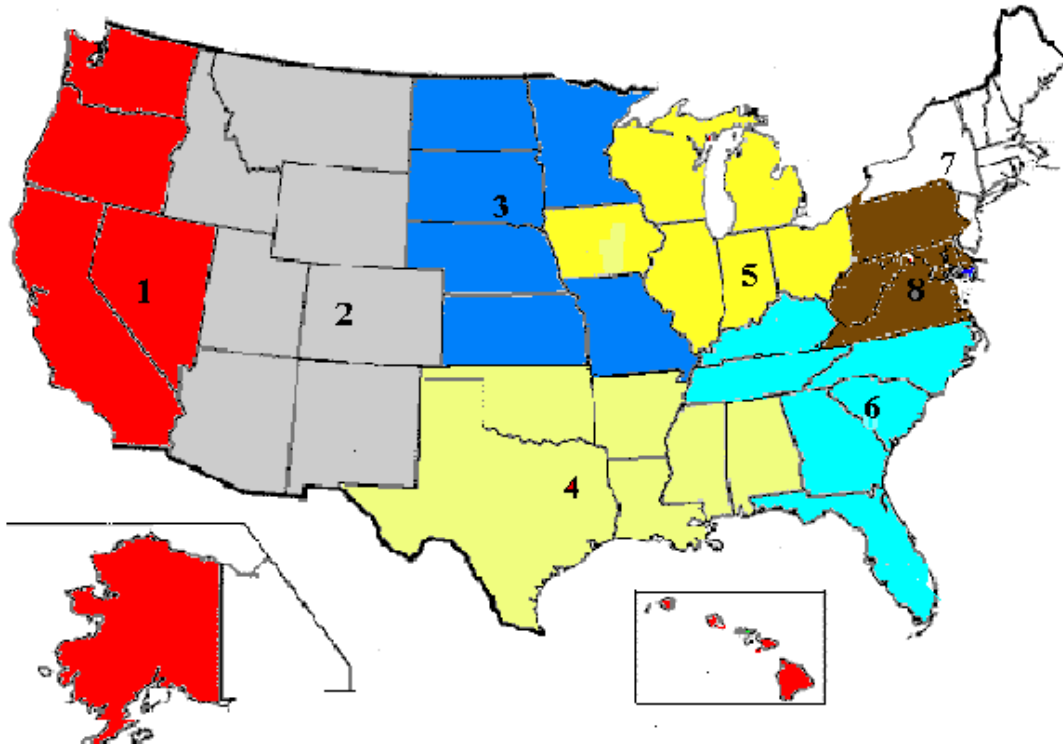
**Windfall Elimination Provision (WEP)** - A social security benefit formula that may be used for workers who receive both a social security retirement or disability benefit AND a pension based on work not covered under social security. The WEP benefit formula produces a lower social security retirement or disability insurance benefit.



# Appendix

The following pages contain organizational maps and important documents referred to in the text. Many other related documents may be found at the web sites [www.irs.gov](http://www.irs.gov), [www.ssa.gov](http://www.ssa.gov), and [www.ncsssa.org](http://www.ncsssa.org).

**MAP OF AREA JURISDICTION OF IRS FEDERAL, STATE, AND LOCAL GOVERNMENTS (FSLG)**



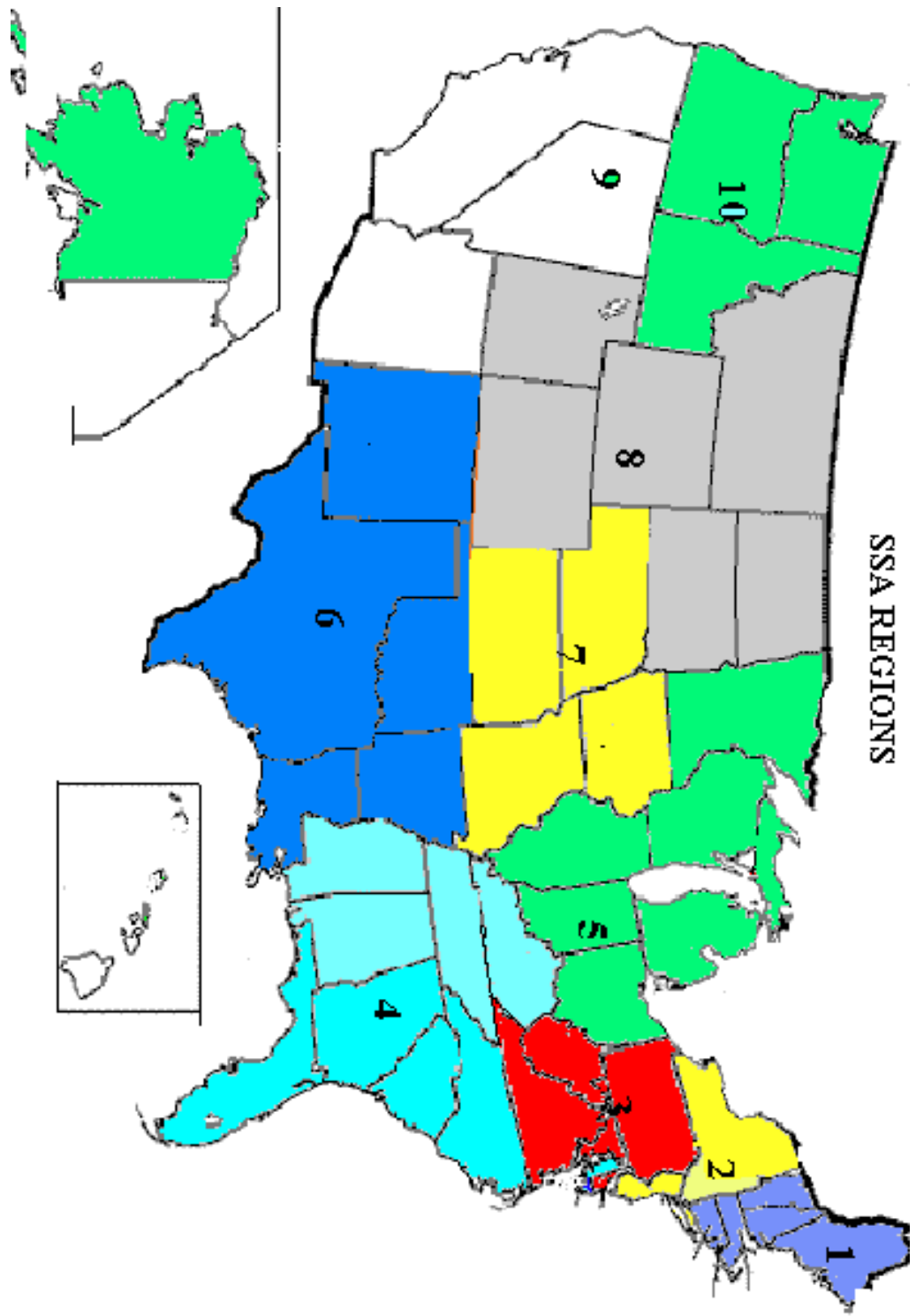
**Federal, State, and Local Governments**

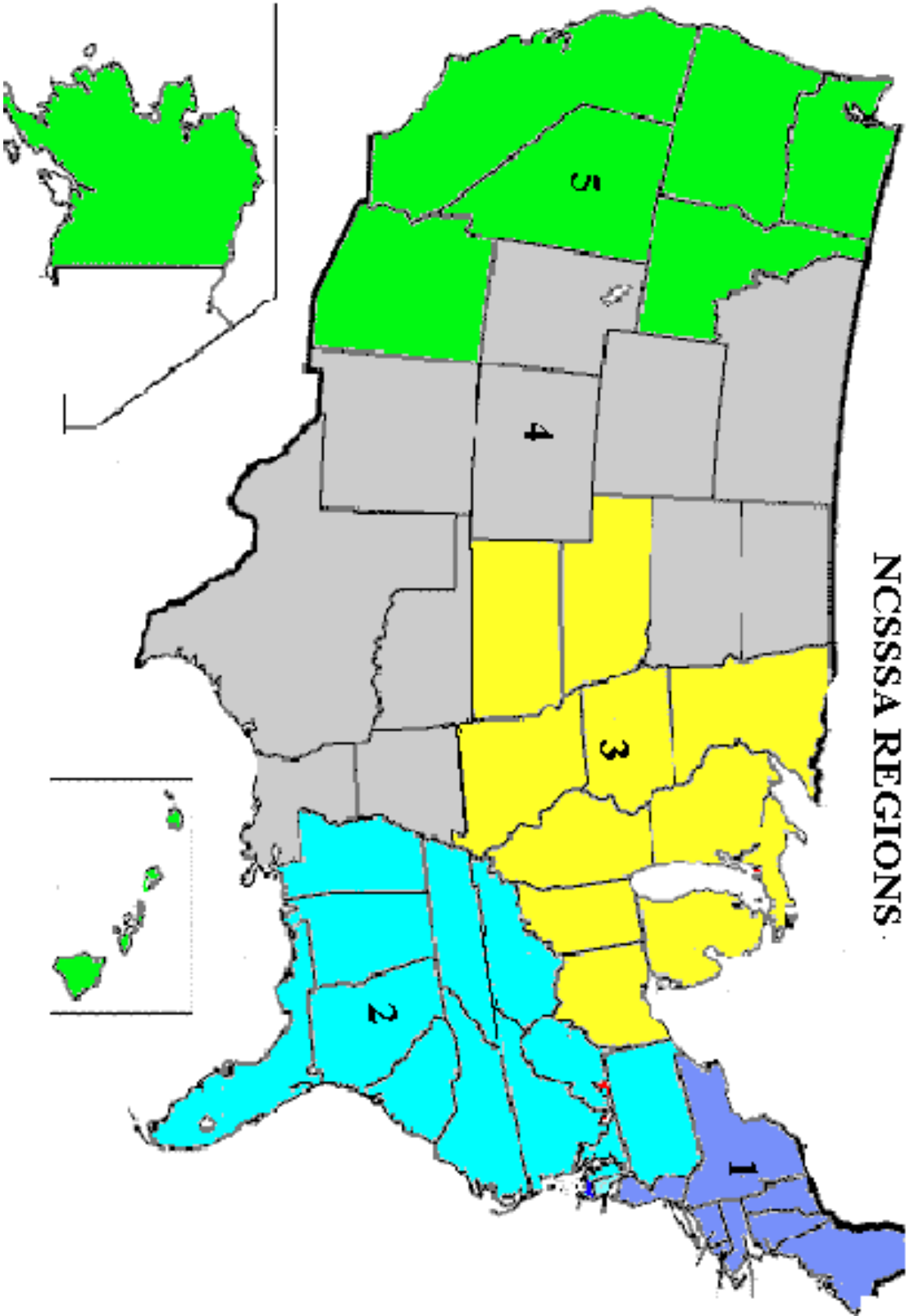
**National Headquarters**

Allen P. Jones, Director, FSLG  
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Telephone: (202) 283-9818  
FAX Number: (202) 283-9797

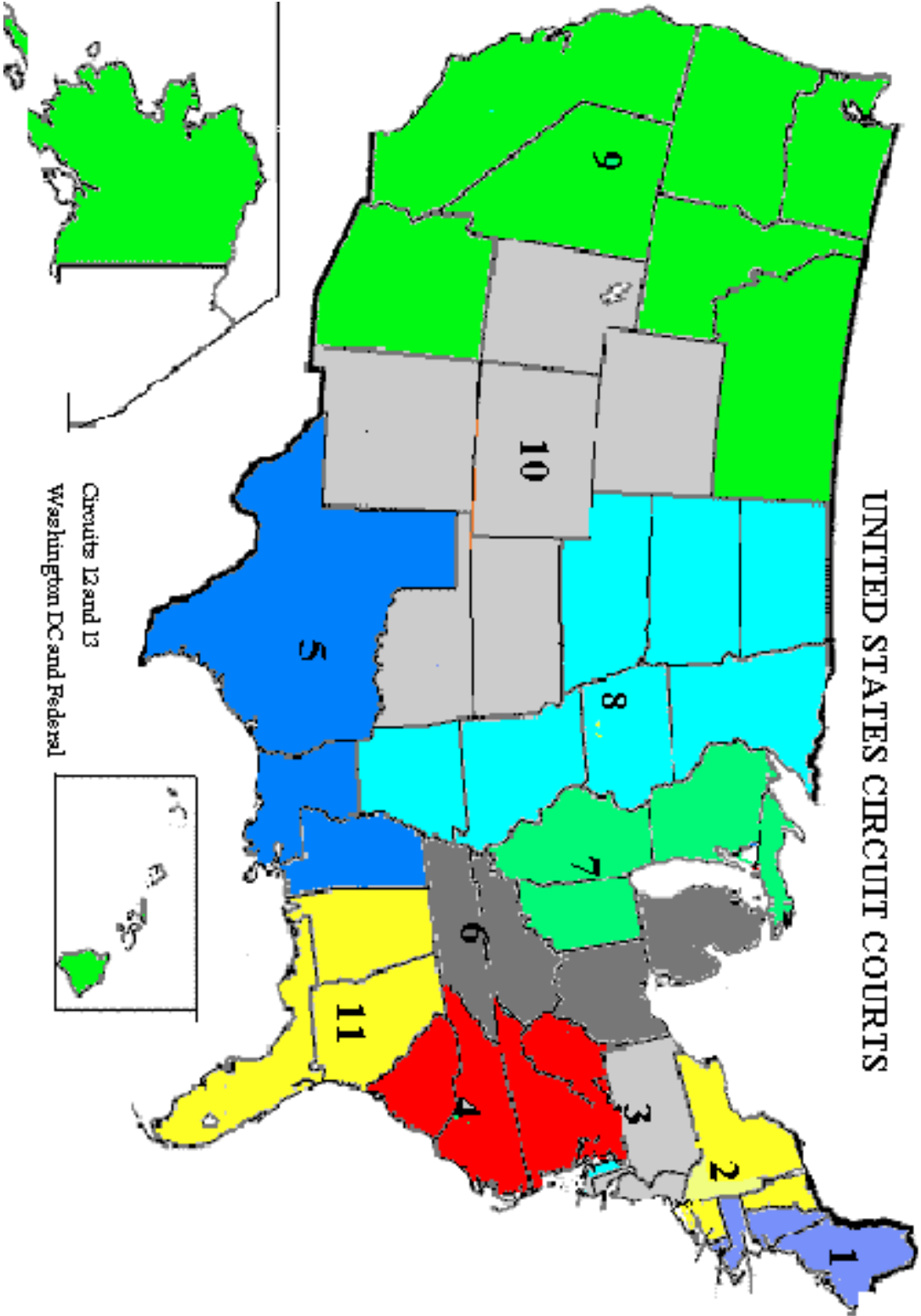
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# VOLUNTARY AGREEMENTS FOR COVERAGE OF STATE AND LOCAL EMPLOYEES

## Purpose of Agreement

SEC. 218. [42 U.S.C. 418] (a)(1) The Commissioner of Social Security shall, at the request of any state, enter into an agreement with such state for the purpose of extending the insurance system established by this title to services performed by individuals as employees of such state or any political subdivision thereof. Each such agreement shall contain such provisions, not inconsistent with the provisions of this section, as the state may request.

(2) Notwithstanding section [210\(a\)](#), for the purposes of this title the term "employment" includes any service included under an agreement entered into under this section.

### *Definitions*

(b) For the purposes of this section--

(1) The term "State" does not include the District of Columbia, Guam, or American Samoa.

(2) The term "political subdivision" includes an instrumentality of (A) a State, (B) one or more political subdivisions of a State, or (C) a State and one or more of its political subdivisions.

(3) The term "employee" includes an officer of a State or political subdivision.

(4) The term "retirement system" means a pension, annuity, retirement, or similar fund or system established by a State or by a political subdivision thereof.

(5) The term "coverage group" means (A) employees of the State other than those engaged in performing service in connection with a proprietary function; (B) employees of a political subdivision of a State other than those engaged in performing service in connection with a proprietary function; (C) employees of a State engaged in performing service in connection with a single proprietary function; or (D) employees of a political subdivision of a State engaged in performing service in connection with a single proprietary function. If under the preceding sentence an employee would be included in more than one coverage group by reason of the fact that he performs service in connection with two or more proprietary functions or in connection with both a proprietary function and a nonproprietary function, he shall be included in only one such coverage group. The determination of the coverage group in which such employee shall be included shall be made in such manner as may be specified in the agreement. Persons employed under section 709 of title 32, United States Code, who elected under section [6](#) of the National Guard Technicians Act of 1968 to remain covered by an employee retirement system of, or plan sponsored by, a State or the Commonwealth of Puerto Rico, shall, for the purposes of this Act, be employees of the State or the Commonwealth of Puerto Rico and (notwithstanding the preceding provisions of this paragraph), shall be deemed to be a separate coverage group. For purposes of this section, individuals employed pursuant to an agreement, entered into pursuant to section 205 of the Agricultural Marketing Act of 1946 (7 U.S.C. 1624) or section [14](#) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499n), between a State and the United States Department of Agriculture to perform services as inspectors of agricultural products may be deemed, at the option of the State, to be employees of the State and (notwithstanding the preceding provisions of this paragraph) shall be deemed to be a separate coverage group.

### *Services Covered*

(c)(1) An agreement under this section shall be applicable to any one or more coverage groups designated by the State.

(2) In the case of each coverage group to which the agreement applies, the agreement must include all services (other than services excluded by or pursuant to subsection (d) or paragraph (3), (5), or (6) of this subsection) performed by individuals as members of such group.

(3) Such agreement shall, if the State requests it, exclude (in the case of any coverage group) any one or more of the following:

(A) All services in any class or classes of (i) elective positions, (ii) part-time positions, or (iii) positions the compensation for which is on a fee basis;

(B) All services performed by individuals as members of a coverage group in positions covered by a retirement system on the date such agreement is made applicable to such coverage group, but only in the case of individuals who, on such date (or, if later, the date on which they first occupy such positions), are not eligible to become members of such system and whose services in such positions have not already been included under such agreement pursuant to subsection (d)(3).

(4) The Commissioner of Social Security shall, at the request of any State, modify the agreement with such State so as to (A) include any coverage group to which the agreement did not previously apply, or (B) include, in the case of any coverage group to which the agreement applies, services previously excluded from the agreement; but the agreement as so modified may not be inconsistent with the provisions of this section applicable in the case of an original agreement with a State. A modification of an agreement pursuant to clause (B) of the preceding sentence may apply to individuals to whom paragraph (3)(B) is applicable (whether or not the previous exclusion of the service of such individuals was pursuant to such paragraph), but only if such individuals are, on the effective date specified in such modification, ineligible to be members of any retirement system or if the modification with respect to such individuals is pursuant to subsection (d)(3).

(5) Such agreement shall, if the State requests it, exclude (in the case of any coverage group) any agricultural labor, or service performed by a student, designated by the State. This paragraph shall apply only with respect to service which is excluded from employment by any provision of section [210\(a\)](#) other than paragraph (7) of such section and service the remuneration for which is excluded from wages by subparagraph (B) of section [209\(a\)\(7\)](#).

(6) Such agreement shall exclude--

(A) service performed by an individual who is employed to relieve him from unemployment,

(B) service performed in a hospital, home, or other institution by a patient or inmate thereof,

(C) covered transportation service (as determined under section [210\(k\)](#)),

(D) service (other than agricultural labor or service performed by a student) which is excluded from employment by any provision of section [210\(a\)](#) other than paragraph (7) of such section,

(E) service performed by an individual as an employee serving on a temporary basis in case of fire, storm, snow, earthquake, flood, or other similar emergency, and

(F) service described in section [210\(a\)\(7\)\(F\)](#) which is included as "employment" under section [210\(a\)](#).

(7) No agreement may be made applicable (either in the original agreement or by any modification thereof) to service performed by any individual to whom paragraph (3)(B) is applicable unless such agreement provides (in the case of each coverage group involved) either that the service of any individual to whom such paragraph is applicable and who is a member of such coverage group shall continue to be covered by such agreement in case he thereafter becomes eligible to be a member of a retirement system, or that such service shall cease to be so covered when he becomes eligible to be a member of such a system (but only if the agreement is not already applicable to such system pursuant to subsection (d)(3)), whichever may be desired by the State.

(8)(A) Notwithstanding any other provision of this section, the agreement with any State entered into under this section may at the option of the State be modified at any time to exclude service performed by election officials or election workers if the remuneration

paid in a calendar year for such service is less than \$1,000 with respect to service performed during any calendar year commencing on or after January 1, 1995, ending on or before December 31, 1999, and the adjusted amount determined under subparagraph (B) for any calendar year commencing on or after January 1, 2000, with respect to service performed during such calendar year. Any modification of an agreement pursuant to this paragraph shall be effective with respect to services performed in and after the calendar year in which the modification is mailed or delivered by other means to the Commissioner of Social Security.

(B) For each year after 1999, the Commissioner of Social Security shall adjust the amount referred to in subparagraph (A) at the same time and in the same manner as is provided under section [215\(a\)\(1\)\(B\)\(ii\)](#) with respect to the amounts referred to in section [215\(a\)\(1\)\(B\)\(i\)](#), except that--

(i) for purposes of this subparagraph, 1997 shall be substituted for the calendar year referred to in section [215\(a\)\(1\)\(B\)\(ii\)\(II\)](#), and

(ii) such amount as so adjusted, if not a multiple of \$100, shall be rounded to the next higher multiple of \$100 where such amount is a multiple of \$50 and to the nearest multiple of \$100 in any other case.

The Commissioner of Social Security shall determine and publish in the Federal Register each adjusted amount determined under this subparagraph not later than November 1 preceding the year for which the adjustment is made.

#### ***Positions Covered By Retirement Systems***

(d)(1) No agreement with any State may be made applicable (either in the original agreement or by any modification thereof) to any service performed by employees as members of any coverage group in positions covered by a retirement system either (A) on the date such agreement is made applicable to such coverage group, or (B) on the date of enactment of the succeeding paragraph of this subsection (except in the case of positions which are, by reason of action by such State or political subdivision thereof, as may be appropriate, taken prior to the date of enactment of such succeeding paragraph, no longer covered by a retirement system on the date referred to in clause (A), and except in the case of positions excluded by paragraph (5)(A)). The preceding sentence shall not be applicable to any service performed by an employee as a member of any coverage group in a position (other than a position excluded by paragraph (5)(A)) covered by a retirement system on the date an agreement is made applicable to such coverage group if, on such date (or, if later, the date on which such individual first occupies such position), such individual is ineligible to be a member of such system.

(2) It is hereby declared to be the policy of the Congress in enacting the succeeding paragraphs of this subsection that the protection afforded employees in positions covered by a retirement system on the date an agreement under this section is made applicable to service performed in such positions, or receiving periodic benefits under such retirement system at such time, will not be impaired as a result of making the agreement so applicable or as a result of legislative enactment in anticipation thereof.

(3) Notwithstanding paragraph (1), an agreement with a State may be made applicable (either in the original agreement or by any modification thereof) to service performed by employees in positions covered by a retirement system (including positions specified in paragraph (4) but not including positions excluded by or pursuant to paragraph (5)), if the governor of the State, or an official of the State designated by him for the purpose,

certifies to the Commissioner of Social Security that the following conditions have been met:

- (A) A referendum by secret written ballot was held on the question of whether service in positions covered by such retirement system should be excluded from or included under an agreement under this section;
- (B) An opportunity to vote in such referendum was given (and was limited) to eligible employees;
- (C) Not less than ninety days' notice of such referendum was given to all such employees;
- (D) Such referendum was conducted under the supervision of the governor or an agency or individual designated by him; and
- (E) A majority of the eligible employees voted in favor of including service in such positions under an agreement under this section.

An employee shall be deemed an "eligible employee" for purposes of any referendum with respect to any retirement system if, at the time such referendum was held, he was in a position covered by such retirement system and was a member of such system, and if he was in such a position at the time notice of such referendum was given as required by clause (C) of the preceding sentence; except that he shall not be deemed an "eligible employee" if, at the time the referendum was held, he was in a position to which the State agreement already applied, or if he was in a position excluded by or pursuant to paragraph (5). No referendum with respect to a retirement system shall be valid for purposes of this paragraph unless held within the two-year period which ends on the date of execution of the agreement or modification which extends the insurance system established by this title to such retirement system, nor shall any referendum with respect to a retirement system be valid for purposes of this paragraph if held less than one year after the last previous referendum held with respect to such retirement system.

(4) For the purposes of subsection (c) of this section, the following employees shall be deemed to be a separate coverage group--

- (A) all employees in positions which were covered by the same retirement system on the date the agreement was made applicable to such system (other than employees to whose services the agreement already applied on such date);
- (B) all employees in positions which became covered by such system at any time after such date; and
- (C) all employees in positions which were covered by such system at any time before such date and to whose services the insurance system established by this title has not been extended before such date because the positions were covered by such retirement system (including employees to whose services the agreement was not applicable on such date because such services were excluded pursuant to subsection (c)(3)(B)).

(5)(A) Nothing in paragraph (3) of this subsection shall authorize the extension of the insurance system established by this title to service in any policeman's or fireman's position.

(B) At the request of the State, any class or classes of positions covered by a retirement system which may be excluded from the agreement pursuant to paragraph (3) or (5) of subsection (c), and to which the agreement does not already apply, may be excluded from the agreement at the time it is made applicable to such retirement system; except that, notwithstanding the provisions of paragraph (3)(B) of such subsection, such exclusion may not include any services to which such paragraph (3)(B) is applicable. In the case of any such exclusion, each such class so excluded shall, for purposes of this subsection, constitute a separate retirement system in case of any modification of the agreement thereafter agreed to.

(6)(A) If a retirement system covers positions of employees of the State and positions of employees of one or more political subdivisions of the State, or covers positions of

employees of two or more political subdivisions of the State, then, for purposes of the preceding paragraphs of this subsection, there shall, if the State so desires, be deemed to be a separate retirement system with respect to any one or more of the political subdivisions concerned and, where the retirement system covers positions of employees of the State, a separate retirement system with respect to the State or with respect to the State and any one or more of the political subdivisions concerned. Where a retirement system covering positions of employees of a State and positions of employees of one or more political subdivisions of the State, or covering positions of employees of two or more political subdivisions of the State, is not divided into separate retirement systems pursuant to the preceding sentence or pursuant to subparagraph (C), then the State may, for purposes of subsection (e) only, deem the system to be a separate retirement system with respect to any one or more of the political subdivisions concerned and, where the retirement system covers positions of employees of the State, a separate retirement system with respect to the State or with respect to the State and any one or more of the political subdivisions concerned.

(B) If a retirement system covers positions of employees of one or more institutions of higher learning, then, for purposes of such preceding paragraphs there shall, if the State so desires, be deemed to be a separate retirement system for the employees of each such institution of higher learning. For the purposes of this subparagraph, the term "institutions of higher learning" includes junior colleges and teachers colleges. If a retirement system covers positions of employees of a hospital, which is an integral part of a political subdivision, then, for purposes of the preceding paragraphs there shall, if the State so desires, be deemed to be a separate retirement system for the employees of such hospital.

(C) For the purposes of this subsection, any retirement system established by the State of Alaska, California, Connecticut, Florida, Georgia, Illinois, Massachusetts, Minnesota, Nevada, New Jersey, New Mexico, New York, North Dakota, Pennsylvania, Rhode Island, Tennessee, Texas, Vermont, Washington, Wisconsin, or Hawaii, or any political subdivision of any such State, which, on, before, or after the date of enactment of this subparagraph, is divided into two divisions or parts, one of which is composed of positions of members of such system who desire coverage under an agreement under this section and the other of which is composed of positions of members of such system who do not desire such coverage, shall, if the State so desires and if it is provided that there shall be included in such division or part composed of members desiring such coverage the positions of individuals who become members of such system after such coverage is extended, be deemed to be a separate retirement system with respect to each such division or part. If, in the case of a separate retirement system which is deemed to exist by reason of subparagraph (A) and which has been divided into two divisions or parts pursuant to the first sentence of this subparagraph, individuals become members of such system by reason of action taken by a political subdivision after coverage under an agreement under this section has been extended to the division or part thereof composed of positions of individuals who desire such coverage, the positions of such individuals who become members of such retirement system by reason of the action so taken shall be included in the division or part of such system composed of positions of members who do not desire such coverage if (i) such individuals, on the day before becoming such members, were in the division or part of another separate retirement system (deemed to exist by reason of subparagraph (A)) composed of positions of members of such system

who do not desire coverage under an agreement under this section, and (ii) all of the positions in the separate retirement system of which such individuals so become members and all of the positions in the separate retirement system referred to in clause (i) would have been covered by a single retirement system if the State had not taken action to provide for separate retirement systems under this paragraph.

(D)(i) The position of any individual which is covered by any retirement system to which subparagraph (C) is applicable shall, if such individual is ineligible to become a member of such system on August 1, 1956, or, if later, the day he first occupies such position, be deemed to be covered by the separate retirement system consisting of the positions of members of the division or part who do not desire coverage under the insurance system established under this title.

(ii) Notwithstanding clause (i), the State may, pursuant to subsection (c)(4)(B) and subject to the conditions of continuation or termination of coverage provided for in subsection (c)(7), modify its agreement under this section to include services performed by all individuals described in clause (i) other than those individuals to whose services the agreement already applies. Such individuals shall be deemed (on and after the effective date of the modification) to be in positions covered by the separate retirement system consisting of the positions of members of the division or part who desire coverage under the insurance system established under this title.

(E) An individual who is in a position covered by a retirement system to which subparagraph (C) is applicable and who is not a member of such system but is eligible to become a member thereof shall, for purposes of this subsection (other than paragraph (8)), be regarded as a member of such system; except that, in the case of any retirement system a division or part of which is covered under the agreement (either in the original agreement or by a modification thereof), which coverage is agreed to prior to 1960, the preceding provisions of this subparagraph shall apply only if the State so requests and any such individual referred to in such preceding provisions shall, if the State so requests, be treated, after division of the retirement system pursuant to such subparagraph (C), the same as individuals in positions referred to in subparagraph (F).

(F) In the case of any retirement system divided pursuant to subparagraph (C), the position of any member of the division or part composed of positions of members who do not desire coverage may be transferred to the separate retirement system composed of positions of members who desire such coverage if it is so provided in a modification of such agreement which is mailed, or delivered by other means, to the Commissioner of Social Security prior to 1970 or, if later, the expiration of two years after the date on which such agreement, or the modification thereof making the agreement applicable to such separate retirement system, as the case may be, is agreed to, but only if, prior to such modification or such later modification, as the case may be, the individual occupying such position files with the State a written request for such transfer.

Notwithstanding subsection (e)(1), any such modification or later modification, providing for the transfer of additional positions within a retirement system previously divided pursuant to subparagraph (C) to the separate retirement system composed of positions of members who desire coverage, shall be effective with respect to services performed after the same effective date as that which was specified in the case of such previous division.

(G) For the purposes of this subsection, in the case of any retirement system of the State of Florida, Georgia, Minnesota, North Dakota, Pennsylvania, Washington, or Hawaii

which covers positions of employees of such State who are compensated in whole or in part from grants made to such State under title III, there shall be deemed to be, if such State so desires, a separate retirement system with respect to any of the following:

- (i) the positions of such employees;
- (ii) the positions of all employees of such State covered by such retirement system who are employed in the department of such State in which the employees referred to in clause (i) are employed; or
- (iii) employees of such State covered by such retirement system who are employed in such department of such State in positions other than those referred to in clause (i).

(7) The certification by the governor (or an official of the State designated by him for the purpose) required under paragraph (3) shall be deemed to have been made, in the case of a division or part (created under subparagraph (C) of paragraph (6) or the corresponding provision of prior law) consisting of the positions of members of a retirement system who desire coverage under the agreement under this section, if the governor (or the official so designated) certifies to the Commissioner of Social Security that--

- (A) an opportunity to vote by written ballot on the question of whether they wish to be covered under an agreement under this section was given to all individuals who were members of such system at the time the vote was held;
- (B) not less than ninety days' notice of such vote was given to all individuals who were members of such system on the date the notice was issued;
- (C) the vote was conducted under the supervision of the governor or an agency or individual designated by him; and
- (D) such system was divided into two parts or divisions in accordance with the provisions of subparagraphs (C) and (D) of paragraph (6) or the corresponding provision of prior law.

For purposes of this paragraph, an individual in a position to which the State agreement already applied or in a position excluded by or pursuant to paragraph (5) shall not be considered a member of the retirement system.

(8)(A) Notwithstanding paragraph (1), if under the provisions of this subsection an agreement is, after December 31, 1958, made applicable to service performed in positions covered by a retirement system, service performed by an individual in a position covered by such a system may not be excluded from the agreement because such position is also covered under another retirement system.

(B) Subparagraph (A) shall not apply to service performed by an individual in a position covered under a retirement system if such individual, on the day the agreement is made applicable to service performed in positions covered by such retirement system, is not a member of such system and is a member of another system.

(C) If an agreement is made applicable, prior to 1959, to service in positions covered by any retirement system, the preceding provisions of this paragraph shall be applicable in the case of such system if the agreement is modified to so provide.

(D) Except in the case of State agreements modified as provided in subsection (1) and agreements with interstate instrumentalities, nothing in this paragraph shall authorize the application of an agreement to service in any policeman's or fireman's position.

#### ***Effective Date of Agreement***

(e)(1) Any agreement or modification of an agreement under this section shall be effective with respect to services performed after an effective date specified in such agreement or modification; except that such date may not be earlier than the last day of the sixth calendar year preceding the year in which such agreement or modification, as



the case may be, is mailed or delivered by other means to the Commissioner of Social Security.

(2) In the case of service performed by members of any coverage group--

(A) to which an agreement under this section is made applicable, and

(B) with respect to which the agreement, or modification thereof making the agreement so applicable, specifies an effective date earlier than the date of execution of such agreement and such modification, respectively,

the agreement shall, if so requested by the State, be applicable to such services (to the extent the agreement was not already applicable) performed before such date of execution and after such effective date by any individual as a member of such coverage group if he is such a member on a date, specified by the State, which is earlier than such date of execution, except that in no case may the date so specified be earlier than the date such agreement or such modification, as the case may be, is mailed, or delivered by other means, to the Commissioner of Social Security.

(3) Notwithstanding the provisions of paragraph (2) of this subsection, in the case of services performed by individuals as members of any coverage group to which an agreement under this section is made applicable, and with respect to which there were timely paid in good faith to the Secretary of the Treasury amounts equivalent to the sum of the taxes which would have been imposed by sections 3101 and 3111 of the Internal Revenue Code of 1986 had such services constituted employment for purposes of chapter 21 of such Code at the time they were performed, and with respect to which refunds were not obtained, such individuals may, if so requested by the State, be deemed to be members of such coverage group on the date designated pursuant to paragraph (2).

#### ***Duration of Agreement***

(f) No agreement under this section may be terminated, either in its entirety or with respect to any coverage group, on or after the date of the enactment of the Social Security Amendments of 1983.

#### ***Instrumentalities of Two or More States***

(g)(1) The Commissioner of Social Security may, at the request of any instrumentality of two or more States, enter into an agreement with such instrumentality for the purpose of extending the insurance system established by this title to services performed by individuals as employees of such instrumentality. Such agreement, to the extent practicable, shall be governed by the provisions of this section applicable in the case of an agreement with a State.

(2) In the case of any instrumentality of two or more States, if--

(A) employees of such instrumentality are in positions covered by a retirement system of such instrumentality or of any of such States or any of the political subdivisions thereof, and

(B) such retirement system is (on, before, or after the date of enactment of this paragraph) divided into two divisions or parts, one of which is composed of positions of members of such system who are employees of such instrumentality and who desire coverage under an agreement under this section and the other of which is composed of positions of members of such system who are employees of such instrumentality and who do not desire such coverage, and

(C) it is provided that there shall be included in such division or part composed of the positions of members desiring such coverage the positions of employees of such instrumentality who become members of such system after such coverage is extended,

then such retirement system shall, if such instrumentality so desires, be deemed to be a separate retirement system with respect to each such division or part. An individual who is in a position covered by a retirement system divided pursuant to the preceding sentence

and who is not a member of such system but is eligible to become a member thereof shall, for purposes of this subsection, be regarded as a member of such system. Coverage under the agreement of any such individual shall be provided under the same conditions, to the extent practicable, as are applicable in the case of the States to which the provisions of subsection (d)(6)(C) apply. The position of any employee of any such instrumentality which is covered by any retirement system to which the first sentence of this paragraph is applicable shall, if such individual is ineligible to become a member of such system on the date of enactment of this paragraph or, if later, the day he first occupies such position, be deemed to be covered by the separate retirement system consisting of the positions of members of the division or part who do not desire coverage under the insurance system established under this title. Services in positions covered by a separate retirement system created pursuant to this subsection (and consisting of the positions of members who desire coverage under an agreement under this section) shall be covered under such agreement on compliance, to the extent practicable, with the same conditions as are applicable to coverage under an agreement under this section of services in positions covered by a separate retirement system created pursuant to subparagraph (C) of subsection (d)(6) or the corresponding provision of prior law (and consisting of the positions of members who desire coverage under such agreement).

(3) Any agreement with any instrumentality of two or more States entered into pursuant to this Act may, notwithstanding the provisions of subsection (d)(5)(A) and the references thereto in subsections (d)(1) and (d)(3), apply to service performed by employees of such instrumentality in any policeman's or fireman's position covered by a retirement system, but only upon compliance, to the extent practicable, with the requirements of subsection (d)(3). For the purpose of the preceding sentence, a retirement system, which covers positions of policemen or firemen or both, and other positions, shall, if the instrumentality concerned so desires, be deemed to be a separate retirement system with respect to the positions of such policemen or firemen, or both, as the case may be.

#### ***Delegation of Functions***

(h) The Commissioner of Social Security is authorized, pursuant to agreement with the head of any Federal agency, to delegate any of the Commissioner's functions under this section to any officer or employee of such agency and otherwise to utilize the services and facilities of such agency in carrying out such functions, and payment therefore shall be in advance or by way of reimbursement, as may be provided in such agreement.

#### ***Wisconsin Retirement Fund***

(i)(1) Notwithstanding paragraph (1) of subsection (d), the agreement with the State of Wisconsin may, subject to the provisions of this subsection, be modified so as to apply to service performed by employees in positions covered by the Wisconsin retirement fund or any successor system.

(2) All employees in positions covered by the Wisconsin retirement fund at any time on or after January 1, 1951, shall, for the purposes of subsection (c) only, be deemed to be a separate coverage group; except that there shall be excluded from such separate coverage group all employees in positions to which the agreement applies without regard to this subsection.

(3) The modification pursuant to this subsection shall exclude (in the case of employees in the coverage group established by paragraph (2) of this subsection) service performed by any individual during any period before he is included under the Wisconsin retirement fund.

(4) The modification pursuant to this subsection shall, if the State of Wisconsin requests it, exclude (in the case of employees in the coverage group established by paragraph (2) of this subsection) all service performed in policemen's positions, all service performed in firemen's positions, or both.

#### ***Certain Positions No Longer Covered By Retirement Systems***

(j) Notwithstanding subsection (d), an agreement with any State entered into under this section prior to the date of the enactment of this subsection may, prior to January 1, 1958, be modified pursuant to subsection (c)(4) so as to apply to services performed by employees, as members of any coverage group to which such agreement already applies (and to which such agreement applied on such date of enactment), in positions (1) to which such agreement does not already apply, (2) which were covered by a retirement system on the date such agreement was made applicable to such coverage group, and (3) which, by reason of action by such State or political subdivision thereof, as may be appropriate, taken prior to the date of the enactment of this subsection, are no longer covered by a retirement system on the date such agreement is made applicable to such services.

#### ***Certain Employees of the State of Utah***

(k) Notwithstanding the provisions of subsection (d), the agreement with the State of Utah entered into pursuant to this section may be modified pursuant to subsection (c)(4) so as to apply to services performed for any of the following, the employees performing services for each of which shall constitute a separate coverage group: Weber Junior College, Carbon Junior College, Dixie Junior College, Central Utah Vocational School, Salt Lake Area Vocational School, Center for the Adult Blind, Union High School (Roosevelt, Utah), Utah High School Activities Association, State Industrial School, State Training School, State Board of Education, and Utah School Employees Retirement Board. Any modification agreed to prior to January 1, 1955, may be made effective with respect to services performed by employees as members of any of such coverage groups after an effective date specified therein, except that in no case may any such date be earlier than December 31, 1950. Coverage provided for in this subsection shall not be affected by a subsequent change in the name of a group.

#### ***Policemen and Firemen in Certain States***

(l) Any agreement with a State entered into pursuant to this section may, notwithstanding the provisions of subsection (d)(5)(A) and the references thereto in subsections (d)(1) and (d)(3), be modified pursuant to subsection (c)(4) to apply to service performed by employees of such State or any political subdivision thereof in any policeman's or fireman's position covered by a retirement system in effect on or after the date of the enactment of this subsection, but only upon compliance with the requirements of subsection (d)(3). For the purposes of the preceding sentence, a retirement system which covers positions of policemen or firemen, or both, and other positions shall, if the State concerned so desires, be deemed to be a separate retirement system with respect to the positions of such policemen or firemen, or both, as the case may be.

***Positions Compensated Solely on a Fee Basis***

(m)(1) Notwithstanding any other provision in this section, an agreement entered into under this section may be made applicable to service performed after 1967 in any class or classes of positions compensated solely on a fee basis to which such agreement did not apply prior to 1968 only if the State specifically requests that its agreement be made applicable to such service in such class or classes of positions.

(2) Notwithstanding any other provision in this section, an agreement entered into under this section may be modified, at the option of the State, at any time after 1967, so as to exclude services performed in any class or classes of positions compensation for which is solely on a fee basis.

(3) Any modification made under this subsection shall be effective with respect to services performed after the last day of the calendar year in which the modification is mailed or delivered by other means to the Commissioner of Social Security.

(4) If any class or classes of positions have been excluded from coverage under the State agreement by a modification agreed to under this subsection, the Commissioner of Social Security and the State may not thereafter modify such agreement so as to again make the agreement applicable with respect to such class or classes of positions.

(n)(1) The Commissioner of Social Security shall, at the request of any State, enter into or modify an agreement with such State under this section for the purpose of extending the provisions of title XVIII, and sections 226 and 226A, to services performed by employees of such State or any political subdivision thereof who are described in paragraph (2).

(2) This subsection shall apply only with respect to employees--

(A) whose services are not treated as employment as that term applies under section [210\(p\)](#) by reason of paragraph (3) of such section; and

(B) who are not otherwise covered under the State's agreement under this section.

(3) For purposes of sections 226 and 226A of this Act, services covered under an agreement pursuant to this subsection shall be treated as "medicare qualified government employment".

(4) Except as otherwise provided in this subsection, the provisions of this section shall apply with respect to services covered under the agreement pursuant to this subsection.

## Amended Section 530 of the Revenue Act of 1978

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### *(a) Termination of Certain Employment Tax Liability.*

#### **(1) In general.**

- If -

**(A)** for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and

**(B)** in the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee,

then, for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

#### **(2) Statutory standards providing one method of satisfying the requirements of paragraph (1).**

- For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

**(A)** judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

**(B)** a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or

**(C)** long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

**(3) Consistency required in the case of prior tax treatment.**

- Paragraph (1) shall not apply with respect to the treatment of any individual for employment tax purposes for any period ending after December 31, 1978, if the taxpayer (or a predecessor) has treated any individual holding a substantially similar position as an employee for purposes of the employment taxes for any period beginning after December 31, 1977.

**(4) Refund or credit of overpayment.**

- If refund or credit of any overpayment of an employment tax resulting from the application of paragraph (1) is not barred on the date of the enactment of this Act (Nov. 6, 1978) by any law or rule of law, the period for filing a claim for refund or credit of such overpayment (to the extent attributable to the application of paragraph (1)) shall not expire before the date 1 year after the date of the enactment of this Act (Nov. 6, 1978).

***(b) Prohibition Against Regulations and Rulings on Employment Status.***

- No regulation or Revenue Ruling shall be published on or after the date of the enactment of this Act (Nov. 6, 1978) and before the effective date of any law hereafter enacted clarifying the employment status of individuals for purposes of the employment taxes by the Department of the Treasury (including the Internal Revenue Service) with respect to the employment status of any individual for purposes of the employment taxes.

***(c) Definitions.***

- For purposes of this section -

**(1) Employment tax.** - The term 'employment tax' means any tax imposed by subtitle C of the Internal Revenue Code of 1986 (formerly I.R.C. 1954, section 3101 et seq. of this title).

**(2) Employment status.** - The term 'employment status' means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an employee).

***(d) Exception.***

- This section shall not apply in the case of an individual who, pursuant to an arrangement between the taxpayer and another person, provides services for such other person as an engineer, designer, drafter, computer

programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work.

***(e) Special Rules For Application of Section.***

**(1) NOTICE OF AVAILABILITY OF SECTION**

- An officer or employee of the Internal Revenue Service shall, before or at the commencement of any audit inquiry relating to the employment status of one or more individuals who perform services for the taxpayer, provide the taxpayer with a written notice of the provisions of this section.

**(2) RULES RELATING TO STATUTORY STANDARDS**

- For purposes of subsection (a)(2) -

**(A)** a taxpayer may not rely on an audit commenced after December 31, 1996, for purposes of subparagraph (B) thereof unless such audit included an examination for employment tax purposes of whether the individual involved (or any individual holding a position substantially similar to the position held by the individual involved) should be treated as an employee of the taxpayer,

**(B)** in no event shall the significant segment requirement of subparagraph (C) thereof be construed to require a reasonable showing of the practice of more than 25 percent of the industry (determined by not taking into account the taxpayer), and

**(C)** in applying the long-standing recognized practice requirement of subparagraph (C) thereof-

**(i)** such requirement shall not be construed as requiring the practice to have continued for more than 10 years, and

**(ii)** a practice shall not fail to be treated as long-standing merely because such practice began after 1978.

(3) AVAILABILITY OF SAFE HARBORS

- Nothing in this section shall be construed to provide that subsection (a) only applies where the individual involved is otherwise an employee of the taxpayer.

(4) BURDEN OF PROOF-

**(A) IN GENERAL**

- If-

**(i)** a taxpayer establishes a prima facie case that it was reasonable not to treat an individual as an employee for purposes of this section, and

**(ii)** the taxpayer has fully cooperated with reasonable requests from the Secretary of the Treasury or his delegate,

then the burden of proof with respect to such treatment shall be on the Secretary.

**(B) EXCEPTION FOR OTHER REASONABLE BASIS**

- In the case of any issue involving whether the taxpayer had a reasonable basis not to treat an individual as an employee for purposes of this section, subparagraph (A) shall only apply for purposes of determining whether the taxpayer meets the requirements of subparagraph (A), (B), or (C) of subsection (a)(2).

(5) PRESERVATION OF PRIOR PERIOD SAFE HARBOR

- If -

**(A)** an individual would (but for the treatment referred to in subparagraph (B)) be deemed not to be an employee of the taxpayer under subsection (a) for any prior period, and

**(B)** such individual is treated by the taxpayer as an employee for employment tax purposes for any subsequent period,



then, for purposes of applying such taxes for such prior period with respect to the taxpayer, the individual shall be deemed not to be an employee.

(6) SUBSTANTIALLY SIMILAR POSITION

- For purposes of this section, the determination as to whether an individual holds a position substantially similar to a position held by another individual shall include consideration of the relationship between the taxpayer and such individuals.

## Revenue Procedure 85-18

26 which provides instructions for implementing the provisions of section 530 of the Revenue Act of 1978, 1978-3 (Vol. 1) C.B. xi, 119 (the Act), relating to the employment tax status of independent contractors and employees.

### SEC. 2. BACKGROUND

.01 Rev. Proc. 81-43 is superseded to reflect changes made to section 530 of the Act by section 269(c) of the Tax Equity and Fiscal Responsibility Act of 1982, 1982-2 C.B. 462, 536, which extends the provisions of section 530 indefinitely.

Section 530(a)(1) of the Act, as amended, provides that if, for purposes of the employment taxes under subtitle C of the Internal Revenue Code, a taxpayer did not treat an individual as an employee for any period, then the individual will be deemed not to be an employee for that period, unless the taxpayer had no reasonable basis for not treating the individual as an employee. For any period after December 31, 1978, the relief applies only if (1) all federal tax returns (including information returns) required to be filed by the taxpayer with respect to the individual for the period are filed on a basis consistent with the taxpayer's treatment of the individual as not being an employee, and (2) the treatment is consistent with the treatment for periods beginning after December 31, 1977.

.02 A new section 3.02 titled "Filing of Returns" has been added stating that relief under section 530(a)(1) of the Act will not be granted if a Form 1099 has not been timely filed for each worker for any period after December 31, 1978.

.03 Section 3.05 (relating to refunds, credits, and abatement) is clarified to state that it does not apply to periods in which a taxpayer "treated" an individual as an employee.

### SEC. 3. APPLICATION

#### .01 "Safe Haven" Rules

There are several alternative standards that constitute "safe havens" in determining whether a taxpayer has a "reasonable basis" for not treating an individual as an employee. Reasonable reliance on any one of the following "safe havens" is sufficient:

(A) judicial precedent or published rulings, whether or not relating to the particular industry or business in which the taxpayer is engaged, or technical advice, a letter ruling, or a determination letter pertaining to the taxpayer; or

(B) a past Internal Revenue Service audit (not necessarily for employment tax purposes) of the taxpayer, if the audit entailed to assessment attributable to the taxpayer's employment tax treatment of individuals holding positions substantially similar to the position held by the individual whose status is at issue (a taxpayer does not meet this test if, in the conduct of a prior audit, an assessment attributable to the taxpayer's treatment of the individual was offset by other claims asserted by the taxpayer); or

(C) long-standing recognized practice of a significant segment of the industry in which the individual was engaged (the practice need not be uniform throughout an entire industry).

A taxpayer who fails to meet any of the three "safe havens" may nevertheless be entitled to relief if the taxpayer can demonstrate, in some other manner, a reasonable basis for not treating the individual as an employee. In H.R. Rep. No. 95-1748, 95th Cong., 2d Sess. 5 (1978), 1978-3 (Vol. 1) C.B. 629, 633, it is indicated that "reasonable basis" should be construed liberally in favor of the taxpayer.

#### .02 Filing of Returns.

For any period after December 31, 1978, the relief under section 530(a)(1) will not apply, even if the taxpayer has met the "safe haven" rules of paragraph 3.01 of this revenue procedure, if the appropriate Form 1099 has not been timely filed with respect to the workers involved. See Rev. Rul. 81-224, 1981-2 C.B. 197.

#### .03 Interpreting the Word "Treat"

In determining whether a taxpayer did not "treat" an individual as an employee for any period within the meaning of section 530(a)(1) of the Act, the following guidelines should be followed:

(A) The withholding of income tax or the Federal Insurance Contributions Act (FICA) tax from an individual's wages is "treatment" of the individual as an employee, whether or not the tax is paid over to the Government.

(B) Except as provided in paragraph (C) and (E) below, the filing of an employment tax return (including Forms 940 (Employer's Annual Federal Unemployment Tax Return), 941 (Employer's Quarterly Federal Tax Return), 942 (Employer's Quarterly Tax Return for Household Employees), 943 (Employer's Annual Tax Return for Agricultural Employees), and W-2 (Wage and Tax Statement)) for a period with respect to an individual, whether or not tax was withheld from the individual, is "treatment" of the individual as an employee for that period.

(C) The Filing of a delinquent or amended employment tax return for a particular tax period with respect to an individual as a result of Service compliance procedures is not "treatment" of the individual as an employee for that period. For this purpose, Collection or Examination activities constitute compliance procedures. For example, if the Service determines as a result of an audit that a taxpayer's workers are common law employees, that determination is not "treatment" of the workers as employees for the period under audit. However, if the taxpayer withholds employment taxes or files employment tax returns with respect to those workers for the periods following the period under audit, the action is "treatment" of the workers as employees for those later periods.

(D) Internal Revenue Service Center notices that merely advise the taxpayer that no return has been filed and request information from the taxpayer are not compliance procedures.

(E) A return prepared by the Service under section 6020(b) of the Code is not "treatment" of an individual as an employee; nor is the signing of an audit Form 2504 (Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment).

#### .04 Consistency in prior periods

The relief under section 530(a)(1) of the Act, as amended, does not apply to the employment tax treatment of any individual for any period ending after December 31, 1978, if the taxpayer (or a predecessor) treated any individual holding a substantially similar position as an employee for employment tax purposes for any period beginning after December 31, 1977. However, relief will not be denied under the consistency provision for any periods prior to the period in which the individuals were treated as employees. For example, a taxpayer did not treat an individual as an employee in 1978 and 1979. In 1980, the taxpayer began treating individuals holding substantially similar positions as employees. This subsequent treatment does not prevent the taxpayer from receiving relief under section 530(a)(1) for 1978 and 1979. The application of the consistency rule prevents taxpayers from changing the way they treat workers solely to

take advantage of the relief provisions. The application of this provision to predecessors is intended to prevent evasion of this rule, for example, by reincorporations.

#### .05 Refunds, Credits, and Abatements

Relief under section 530(a)(1) of the Act is available to taxpayers who are under audit by the Service or who are involved in administrative (including Appellate) or judicial processes with respect to assessments based on employment status reclassifications. Relief also is extended to any claim for a refund or credit of any overpayment of an employment tax resulting from the termination of liability under section 530(a)(1), provided the claim is not barred on the date of enactment of this provision (November 6, 1978) by any law or rule of law.

Taxpayers who have entered into final closing agreements under section 7121 of the Code or compromises under section 7122 with respect to employment status controversies are ineligible for relief under the Act, unless they have not completely paid their liability. Thus, for example, a taxpayer who has agreed to or compromised a liability for an amount which is to be paid in installments, but who still has one or more installments to pay, is relieved of liability for such outstanding installments. Taxpayers who settled employment status controversies administratively with the Service on any basis other than section 7121 or 7122 of the Code or who unsuccessfully litigated such cases also are eligible for relief, provided their claims are not barred by the statute of limitations or by the application of the doctrine of *res judicata*. However, unpaid judgments will be abated if section 530(a)(1) of the Act applies. Thus, an unsuccessful litigant in an employment status case who fulfills the Act's requirements can avoid collection of any unpaid employment tax liabilities, regardless of the doctrine of *res judicata*.

The application of the doctrine of *res judicata* will prevent a refund based on section 530(a)(1) of the Act if a taxpayer paid a judgment in an action relating to the same issue as to the same taxpayer. Thus, if the specific matter was judicially decided and the judgment paid, relief under section 530(a)(1) is not available.

This subsection will not apply to those periods in which a taxpayer "treated" an individual as an employee within the meaning of subsection .03 of this section.

#### .06 Handling of Claims

Relief under section 530(a)(1) of the Act applies to the taxes imposed on an employer by sections 3111 or 3301 of the Code. It also applies to an employer's liability under section 3102 and 3403 to withhold and pay the taxes imposed by sections 3101 and 3402. Therefore, an unpaid assessment of those taxes against an employer who qualifies for relief under section 530(a)(1) of the Act should be abated. Timely claims for refund of such taxes paid by a taxpayer who qualifies for relief will be honored.

#### .07 Interest and Penalties

If a taxpayer is relieved of liability under section 530(a)(1) of the Act, any liability for interest or penalties attributable to that liability is forgiven automatically. This relief from interest and penalties applies whether charged directly against the taxpayer or personally against a corporate taxpayer's officers.

#### .08 Status of Workers

Section 530 of the Act does not change in any way the status, liabilities, and rights of the worker whose status is at issue. Section 530(a)(1) terminates the liability of the

employer for the employment taxes but has no effect on the workers. It does not convert individuals from the status of employee to the status of self-employed.

Section 31.3102-1(c) of the regulations provides, with respect to the collection and payment of the employee's share of the FICA tax, that "until collected from him [by [\*10] the employer] the employee is also liable for the employee tax with respect to all wages received by him." Therefore, if an employer's liability under section 3102 of the Code for the employee's share of the tax imposed by section 3101 is terminated under section 530(a)(1) of the Act, the employee remains liable for that tax. Employees who incorrectly paid the self-employment tax (section 1401 of the Code) may file a claim for refund; however, the amount of the self-employment tax refund will be offset by the amount of the employee's share of the tax imposed on the employee as a result of the application of section 31.3102-1(c) of the regulations.

#### .09 Definition of Employee

For purposes of section 530(a) of the Act, the term employee means employees under sections 3121(d), 3306(i), and 3401(c) of the Code.

#### SEC. 4.EFFECT ON OTHER DOCUMENTS

Rev. Proc. 81-43 is amplified and superseded.

## **Revenue Ruling 86-88**

### **FICA; HOSPITAL INSURANCE; EXTENSION TO STATE AND POLITICAL SUBDIVISION EMPLOYEES**

This revenue ruling provides guidelines concerning the applicability of the Medicare tax to employees of states and political subdivisions.

For purposes of this revenue ruling, the term 'state' includes the Commonwealth of Puerto Rico, the Virgin Islands, and the District of Columbia.

For purposes of this revenue ruling, the term 'political subdivision' has the same meaning that it has under section 218(b)(2) of the Social Security Act, 42 U.S.C. section 418(b)(2). Thus, 'political subdivision' ordinarily includes a county, city, town, village, or school district. In many states, depending upon the manner in which such entities are created under state law, 'political subdivision' includes a sanitation, utility, reclamation, improvement, drainage, irrigation, flood control, or similar district.

For purposes of this revenue ruling, the term 'state employer' of a state includes the state and any agency or instrumentality of that state that is a separate employer for purposes of withholding, paying, and reporting the federal income taxes of employees. The term 'political subdivision employer' of a political subdivision includes the political subdivision and any agency or instrumentality of that political subdivision that is a separate employer for purposes of withholding, reporting, and paying the federal income taxes of employees.

#### **SERVICES SUBJECT TO THE MEDICARE TAX**

Q1. What services are subject to the Medicare tax under the Act?

A1. As a general rule, services performed for a state employer or political subdivision employer by an employee hired by the state employer or political

subdivision employer after March 31, 1986, are subject to the Medicare tax. The following services, however, are NOT subject to the Medicare tax even though the services are performed by an employee hired after March 31, 1986:

(1) services covered by an agreement between the state and the Secretary of Health and Human Services entered into pursuant to section 218 of the Social Security Act, 42 U.S.C. section 418 (218 agreement) providing for social security coverage including Medicare,

(2) services excluded from the definition of employment under any provision of section 3121(b) of the Code other than section 3121(b)(7),

(3) services performed by an individual who is employed by a state employer

(except for a District of Columbia employer) or a political subdivision employer to relieve the individual of unemployment,

(4) services performed in a hospital, home, or other institution by a patient or inmate thereof as an employee of a state employer or a political subdivision employer,

(5) services performed by an individual as an employee of a state employer or a political subdivision employer serving on a temporary basis in case of fire, storm, snow, earthquake, flood, or other similar emergency, or

(6) services performed by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of the District of Columbia government), other than as a medical or dental intern or a medical or dental resident in training.

#### THE CONTINUING EMPLOYMENT EXCEPTION

Q2. If an employee was hired before April 1, 1986, by a state employer or a political subdivision employer and services are performed for the state employer or political subdivision employer by that employee after March 31,

1986, are those services subject to the Medicare tax?

A2. Services are not subject to the tax if they are performed after March 31, 1986, for a state employer or political subdivision employer by an employee who was hired by the state employer or the political subdivision employer before April 1, 1986, and if the employee meets the following requirements:

(i) the employee was performing regular and substantial services for remuneration for the state employer or political subdivision employer before April 1, 1986,

(ii) the employee was a bona fide employee of that employer on March 31, 1986,

(iii) the employment relationship with that employer was not entered into for purposes of avoiding the Medicare tax, and

(iv) the employment relationship of the employee with that employer has not been terminated after March 31, 1986 (other than as provided in the rules described in Q&A8 below, which concern employees who transfer from one state employer, or one political subdivision employer, to another).

Section 3121(u)(2)(C) of the Code.

For purposes of this revenue ruling, this exception to the Medicare tax is called the 'continuing employment exception.'

Q3. An employee signed an employment contract before April 1, 1986, but did not begin to perform services until after March 31, 1986. Does the employee qualify for the continuing employment exception?

A3. No. The employee does not qualify for the continuing employment exception because the employee was not performing regular and substantial services for remuneration before April 1, 1986. Section 3121(u)(2)(C)(ii)(I) of the Code.

Q4. Before April 1, 1986, an individual was performing services for remuneration as a substitute teacher on an 'as needed' basis for a state employer or a political subdivision employer, and the individual continued performing those services on that basis after March 31, 1986. Does the individual qualify for the continuing employment exception?

A4. No. The individual does not qualify for the continuing employment exception. Even though the services performed may have been substantial, the services were not regular because they were performed on an 'as needed' basis. Section 3121(u)(2)(C)(ii)(I) of the Code.

Q5. A was a state employee performing regular and substantial services for remuneration prior to April 1, 1986. A's employment relationship with the state employer was terminated after March 31, 1986, but A was later rehired by the state employer. Does the continuing employment exception apply to A?

A5. No. Section 3121(u)(2)(C)(iii) of the Code.

Q6. How is termination of employment defined for purposes of determining whether the Medicare tax is applicable?

A6. The question of whether an employment relationship has terminated is a question of fact that must be determined on the basis of all the relevant facts and circumstances. Great weight, however, will be given to the personnel rules of the state employer or political subdivision employer to determine whether an employment relationship has been terminated.

Q7. An employee who was hired before April 1, 1986, by a state employer transferred after March 31, 1986, to another state employer of that state. The transfer was made without a termination of the employee's overall employment relationship with that state. Does the employee qualify for the continuing employment exception?

A7. Yes. An employee hired before April 1, 1986, by a state employer who transfers after March 31, 1986, to another state employer of that state may qualify for the continuing employment exception, provided the transfer was made without a termination of the employee's overall employment relationship with that state. The same rule applies to an employee hired before April 1, 1986, by a political subdivision employer, who transfers after March 31, 1986, to another political subdivision employer of that political subdivision.

On the other hand, an employee hired before April 1, 1986, does not qualify for the continuing employment exception if after March 31, 1986, the employee transfers from a state employer to a political subdivision employer or from a political subdivision employer to a state employer. Likewise, an employee does not qualify for the exception if the employee transfers from a political subdivision employer in one political subdivision to a political subdivision employer in a different political subdivision, or from a state employer in one state to a state employer in a different state. Section 3121(u)(2)(D) of the Code.



Different rules, however, control whether a transfer affects an employee's status for purposes of the Medicare tax wage base. In the case of an employee who is subject to the Medicare tax, even if the employee transfers from one state employer to another state employer of that state or from one political subdivision employer to another political subdivision employer of that political subdivision, a new Medicare tax wage base applies to wages received from the second employer. Thus, the rules that determine whether there is a new Medicare tax wage base are the same as those applicable to employees of private employers.

#### SERVICES EXCLUDED FROM EMPLOYMENT

Q8. What services are excluded from the definition of employment?

A8. See sections 3121(b)(1)-(6), (8)-(20) of the Code for a list of services that are excluded from the definition of employment for purposes of the social security taxes, including the Medicare portion of the taxes.

Q9. A 218 agreement may contain terms optionally excluding from social security coverage certain types of employment. 42 U.S.C. section 418(c)(3). If employment is optionally excluded from coverage under the terms of a 218 agreement, is that employment subject to the Medicare tax if services are performed by an individual otherwise subject to the Medicare tax under the rules of Q&A1 and Q&A2?

A9. Yes. The optionally excluded services are subject to the Medicare tax if they are performed by an individual otherwise subject to the tax under the rules of Q&A1 and Q&A2 above.

Q10. A student is hired by a school, college, or university after March 31, 1986, to perform services for the school, college, or university. The student is in a group optionally excluded from coverage under the terms of an applicable 218 agreement. Are the services performed by the student subject to the Medicare tax?

A10. Services performed by a student employed by a school, college, or university are not subject to the Medicare tax if the student is enrolled and regularly attending classes at the school, college, or university. Section

3121(b)(10) of the Code. Services of a student that are subject to contributions under a 218 agreement continue to be subject to such contributions.

#### DEFINITION OF WAGES

Q11. Is the definition of wages for Medicare tax purposes the same as the definition of wages for making social security contributions under 218 agreements?

A11. No, not in all cases. The term 'wages' for purposes of paying Medicare tax is defined by section 3121(a) of the Code. The term 'wages' for purposes of making contributions under a 218 agreement is defined by section 209 of the Social Security Act. 42 U.S.C. section 409. Questions concerning the definition of wages (and employment) for purposes of paying Medicare tax should be directed to the Service. Questions

concerning the definition of wages (and employment) for purposes of making 218 contributions should be directed to the Social Security Administration (SSA).

#### RULES FOR REPORTING AND PAYMENT OF MEDICARE TAX

Q12. Is the Medicare tax reported and paid to the Internal Revenue Service or to the SSA?

A12. The Medicare tax is reported and paid to the Service (1) by a state employer of a state if on April 7, 1986, NO employee of any state employer of that state was covered under a 218 agreement, and (2) by a political subdivision employer of a political subdivision if on April 7, 1986, NO employee of any political subdivision employer of that political subdivision was covered under a 218 agreement.

The Medicare tax is reported to the state Social Security Administrator (1) by a state employer of a state if on April 7, 1986, ANY employee of any state employer of that state was covered under a 218 agreement, and (2) by a political subdivision employer of a political subdivision if on April 7, 1986, ANY employee of any political subdivision employer of that political subdivision was covered under a 218 agreement.

Q13. A 218 agreement was in effect with state X on or before April 7, 1986. The agreement provided for coverage of employees of a political subdivision employer of political subdivision A but not for coverage of any employee of any political subdivision employer of political subdivision B. After April 7, 1986, a modification of the 218 agreement was executed providing for coverage of some, but not all, employees of a political subdivision employer of political subdivision B. The effective date of the new coverage was April 1, 1986. When that political subdivision employer of political subdivision B reports and pays the Medicare tax on wages for services performed by those of its employees who are not subject to the modification, is the tax reported and paid to the state Social Security Administrator or to the Internal Revenue Service?

A13. The tax is reported and paid to the Internal Revenue Service. Modifying a 218 agreement after April 7, 1986, to extend coverage on a retroactive basis does not change the agency to which the employer must report and pay the Medicare tax for services performed by employees who are subject to the Medicare tax.

Q14. How is the Medicare tax reported and paid to the Internal Revenue Service?

A14. Taxable wages must be reported on line 6 of Form 941E, Quarterly Return of Withheld Federal Income Tax and Hospital Insurance (Medicare) Tax. The reporting, depositing, and paying of the Medicare tax are subject to the same rules applicable to private employers. These rules are similar to those applicable to income tax withholding.

Q15. How is the Medicare tax reported and paid to the SSA?

A15. The Medicare tax is reported and paid to the SSA just as contributions under a 218 agreement are reported and paid to the SSA.

Q16. Will all penalties for failure to pay the Medicare tax and failure to make timely deposits of that tax be assessed against state and political subdivision employers?

A16. The Service will waive penalties for failure to pay and for failure to make timely deposits of the Medicare tax with respect to services performed through the fourth quarter of 1986, so long as all payments due for April through December of 1986 are paid by February 2, 1987. If all payments due for April through December 1986 are not paid by February 2, 1987, this automatic waiver of penalties is not applicable, even with respect to amounts paid by February 2, 1987. Penalties may be waived, however, if the employer shows reasonable cause for failure to pay and failure to make timely deposits of the tax. See sections 6651 and 6656 of the Code. A state employer or political subdivision employer should not report any Medicare tax wages on line 6 of Form

941E for the second or third quarter unless appropriate deposits and/or payments are made for that quarter.

Q17. If a state employer or a political subdivision employer has federal employees on the state or political subdivision payroll, how should that employer report the full social security tax or the Medicare portion of the social security tax, whichever is applicable?

A17. The state employer or political subdivision employer should use Form 941E to report the full social security taxes and or the Medicare portion of the taxes. For those federal employees subject to the FULL social security taxes, the tax must be included with the withheld federal income tax on line 3 of Form 941E, with an attached supporting statement showing the amount of wages subject to the social security taxes, the amount of the taxes withheld, and the employer's share of the taxes. For those federal employees subject ONLY to the Medicare portion of the social security taxes, the Medicare tax must be reported on line 6 of Form 941E.

Q18. If a state employer or a political subdivision employer must report and pay the Medicare tax to the Service as explained in Q&A12, how should the employer transmit Copy A of Forms W-2 for newly hired employees who are subject to the Medicare tax?

A18. For newly hired employees subject to the Medicare tax. the employer should transmit Copy A of Forms W-2 with a Form W-3, Transmittal of Income and Tax Statements, and should check the 'Medicare Fed. emp.' checkbox in Box 2 on the Form W-3. This checkbox will be changed to 'Medicare government employee' on the 1987 Form W-3 to reflect the extension of the Medicare tax to state and political subdivision employees. For employees not subject to the Medicare tax, the employers should follow the current practice of transmitting Copy A of Forms W-2 with a Form W-3, checking the '941/941r' checkbox in Box 2 on the Form W-3.

Q19. If a state employer or a political subdivision employer must report and pay the Medicare tax to the state Social Security Administrator as explained in Q&A12, how should the employer transmit Copy A of Forms W-2 for newly hired employees subject to the Medicare tax?

A19. For newly hired employees subject to the Medicare tax, the employer should transmit Copy A of Forms W-2 with a Form W-3 S&L, Transmittal of Income and Tax Statements for State and Local Governmental Employers, and should check the 'Medicare Government Employee' checkbox on the Form W-3 S&L IN ADDITION TO the 'Section

218' checkbox. For those employees covered under a 218 agreement, the state employer or the political subdivision employer should follow the current practice of transmitting the Forms W-2 with a Form W-3 S&L, checking the 'Section 218' checkbox in Box 2 on the Form W- 3 S&L. If the employer also has employees who are not covered under the 218 agreement and who were hired before April 1, 1986, then for those employees, the employer should transmit Forms W-2 with a Form W-3 and should check the ' 941/941u ' box on the Form W-3.

## **Revenue Ruling 88-36**

### **FICA, HOSPITAL INSURANCE; STATE AND POLITICAL SUBDIVISION EMPLOYEES**

#### **SECTION 3121. - DEFINITIONS**

FICA, hospital insurance; state and political subdivision employees. Guidance is provided, in question and answer form, concerning the application of the hospital insurance (medicare) tax portion of the Federal Insurance Contributions Act (FICA) by section 3121(u) of the Code, to wages for services performed by state and political subdivision employees hired after March 31, 1986. Rev. Rul. 86-88 supplemented.

The Service has issued Rev. Rul. 88-36, supplementing Rev. Rul. 86-88, 1986-2 C.B. 172, in question and answer format, which provides guidelines concerning the 1985 amendment to section 3121(u), which extended Medicare (the hospital portion of FICA) to wages for services rendered by state and political subdivision employees hired after March 31, 1986. The ruling addresses such areas as the types of services which are subject to the medicare tax and the continuing employment exception. In general, an individual, who was employed by a state or political subdivision before March 31, 1986 and who was performing regular and substantial services for remuneration, will not be subject to the tax on services performed after that date. This rule applies only if the employment was not terminated after April 1.

This revenue ruling supplements Rev. Rul. 86-88, 1986-2 C.B. 172, which provides guidelines, in question and answer form, concerning the 1985 amendment of section 3121(u) of the Internal Revenue Code. In general, the amendment extends the hospital insurance (medicare) tax portion of the Federal Insurance Contributions Act (FICA) to wages for services rendered by state and political subdivision employees hired after March 31, 1986.

In this revenue ruling, the terms 'state,' 'political subdivision,' 'state employer,' 'political subdivision employer,' and 'continuing employment exception' have the same meanings as in Rev. Rul. 86-88.

#### **SERVICES SUBJECT TO THE MEDICARE TAX**

Q1. If an individual receiving social security retirement insurance benefits was hired as an employee of a state or political subdivision after March 31, 1986, are the services performed by the individual for the state or political subdivision subject to the medicare tax?

A1. Yes. The fact that an employee is receiving social security retirement insurance benefits does not affect the employee's liability for the medicare tax.

Q2. Are services performed by an election official or election worker for a state employer or political subdivision employer subject to the medicare tax?

A2. Yes, unless the remuneration paid in a calendar year for such service is less than \$100. Section 3121(u)(2)(B)(ii)(V) of the Code, added by section 1895(b)(18)(A) of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 852. This amendment is effective for services rendered after March 31, 1986.

Q3. A township has a small number of regularly employed fire fighters. To assist these fire fighters, certain residents of the township have volunteered their services in cases of emergency. The township alerts these residents to emergencies by sounding a siren. The township keeps a record of the residents who respond to the emergency calls and periodically pays each such resident a nominal amount for each emergency for which the resident performed services. Are the payments made to the residents by the township subject to the medicare tax?

A3. No. The services are considered to be performed by an employee of a state or political subdivision on a temporary basis in case of fire, storm, snow, earthquake, flood, or other similar emergency and thus are not subject to the medicare tax. See Section 3121(u)(2)(B)(ii)(III) of the Code.

#### THE CONTINUING EMPLOYMENT EXCEPTION

Q4. An individual was hired in September 1984 as a part-time cook by a state hospital to perform two hours of paid service each Sunday preparing the evening meal. The individual is not a patient or inmate of the hospital and has worked two hours each week as an employee of the hospital continuously since September 1984. Are the individual's services performed after March 31, 1986, subject to the medicare tax?

A4. No. The continuing employment exception applies here if the individual was performing regular and substantial services for remuneration for the state employer or political subdivision employer before April 1, 1986. Whether this requirement is met is a question of fact. On these facts, the individual's services are determined to be regular and substantial, and the exception applies.

Q5. In November 1982, an individual was elected to a state public office for a four-year term beginning in January 1983, making the individual an employee of the state. In November 1986, the individual was re-elected. Are the individual's services performed in the second term that begins in January 1987 subject to the medicare tax?

A5. No. The continuing employment exception applies here if the employment relationship has not been terminated after March 31, 1986. The individual was re-elected before the first term expired, so there was no break in the employment relationship.

Q6. B, a school district employee, performed regular and substantial services for remuneration for a political subdivision employer during the school year beginning in September 1985 and ending in May 1986. In May 1986, the school district notified B that B's employment would be terminated as of the end of May 1986 because the school district might not receive sufficient funding. B continued to be covered under the school district's health insurance program through August 1986 on the same basis as before May

1986. Sufficient funding was provided, and in September 1986 B began working on the same basis as before. Are B's services performed after August 31, 1986, subject to the medicare tax?

A6. No. In fact, B's employment with the school district was continuous because the school district received sufficient funding. The school district's personnel policies indicate that the employment relationship continued because B retained health insurance coverage. See Q&A6 of Rev. Rul. 86-88.

Q7. C, a professor at a state university, performed regular and substantial services for remuneration for the university from September 1985 to June 1986. C was granted a leave of absence for the 1986-1987 school year, with the right to return to the same position at the end of the leave. In September 1987, C returned from the leave and resumed the same position with the university. Are C's services performed after returning from the leave of absence subject to the medicare tax?

A7. No. The leave of absence was granted by the university and did not terminate the employment relationship. The university's personnel policies indicate that the employment relationship continued because C was given the right to return to the same position. See Q&A6 of Rev. Rul. 86-88.

Q8. D taught a two-hour photography course twice a week at a local community college in the spring semester, which began on March 1, 1986. D then signed a three-year agreement with the college that he would teach the same course every spring. When D returned in the spring of 1987, were his services subject to the medicare tax?

A8. No. D was performing regular and substantial services for remuneration prior to April 1, 1986. The employment relationship was not terminated, as D had a commitment to return to the same position each spring.

Q9. Each summer, a Township Parks Department advertises for workers to cut grass. E was hired by the township in May 1985 to cut grass during that summer. E stopped performing services for the township at the end of that summer. In May 1986, E was again hired by the township to cut grass. Are E's services performed when E returned in May 1986 subject to the medicare tax?

A9. Yes. E's employment relationship was terminated after April 1, 1986, as E had no commitment to perform services for the township each summer.

Q10. A part-time police officer has been paid on a weekly basis since March 10, 1986, to be 'on call' for a set schedule of hours each week. When the officer is 'on call,' he must stay at his residence and be available to provide assistance in the case of an emergency or to handle any police business that may arise. Are the services performed by the officer after April 1, 1986 subject to the medicare tax?

A10. No. Although the officer responds to calls on an 'as needed' basis, he has a set schedule of hours during which he is performing the service of being available to respond to such calls. Based on the above facts, the officer was performing regular and substantial

services for remuneration prior to April 1, 1986 and thus, qualifies for the continuing employment exception to the medicare tax.



## **Revenue Procedure 91-40**

### **SECTION 1. PURPOSE**

This revenue procedure sets forth rules relating to the minimum retirement benefit requirement prescribed under section 31.3121(b)(7)-2 of the Employment Tax Regulations.

### **SECTION 2. BACKGROUND**

Section 3121(b)(7)(F), added to the Internal Revenue Code by section 11332(b) of the Omnibus Budget

Reconciliation Act of 1990, Public Law No. 101-508, 104 Stat. 1388, generally expands the definition of employment, for purposes of the Federal Insurance Contributions Act (FICA), to include service as an employee for a state or local government entity unless the employee is a “member of a retirement system” of such entity. Section 3121(b)(7)(F) is effective with respect to service performed after July 1, 1991. Thus, wages for services performed after July 1, 1991, received by an employee of a state or local government entity who is not a member of a retirement system of such entity will generally be subject to FICA taxes, and will also be taken into account in determining the employee’s eligibility for Social Security and Medicare benefits. Under section 31.3121(b)(7)-2(e) of the regulations, a retirement system generally includes any pension, annuity, retirement or similar fund or system within the meaning of section 218 of the Social Security Act that is maintained by a state, political subdivision or instrumentality thereof to provide retirement benefits to its employees who are participants. However, the definition of retirement system is limited in order to carry out the purposes of section 3121(b)(7)(F) of the Code and the corresponding provisions of the Social Security Act. Under the regulations, in order for service in the employ of a state or local government entity to qualify for the exception from employment under section 3121(b)(7), the employee must be a member of a retirement system that provides certain minimum retirement benefits to that employee. To meet this minimum retirement benefit requirement with respect to an employee, section 31.3121(b)(7)-2(e)(2)(i) of the regulations generally requires that a retirement system provide benefits to the employee that are comparable to those provided in the Old-Age portion of the Old-Age, Survivor, Disability Insurance program under Social Security. Section 31.3121(b)(7)-2(e)(2)(vi) of the regulations provides that the Commissioner may, through guidance of general applicability, promulgate additional testing methods to determine whether, a retirement system meets the minimum retirement benefit requirement. This revenue procedure is an exercise of this authority. It outlines a set of safe harbor formulas for defined benefit retirement systems. Benefits calculated under one of these formulas are deemed to meet the minimum retirement benefit requirement. In addition, procedures are set out by which an employer may determine whether retirement benefits calculated under other formulas meet the minimum retirement benefit requirement of the regulations with respect to an employee.

### **SECTION 3. DEFINED BENEFIT RETIREMENT SYSTEM SAFE HARBOR FORMULAS**

.01 Final and highest average pay formulas.

- (1) Periods of 36 months or less. A defined benefit retirement system that calculates benefits by reference to a participant's average compensation meets the minimum retirement benefit requirement with respect to an employee if it makes available to the employee a single life annuity payable beginning no later than age 65 that is at least 1.5 percent of average compensation for each year (or fraction thereof) of credited service. For this purpose, average compensation may be defined as the average of the employee's compensation over the 36 (or fewer) consecutive or non-consecutive months that provides the highest such average, the average of the employee's compensation for his or her last 36 (or fewer) months of service with the employer, or the average of the employee's compensation for his or her high consecutive or nonconsecutive or final 3 (or fewer) calendar or plan years of service.
- (2) Periods of more than 36 months. A defined benefit retirement system that calculates benefits by reference to a participant's average compensation over a period of more than 36 months meets the minimum benefit requirement in the same manner as a retirement system described in section 3.01(l) except that the 1.5 percent factor is replaced with a higher factor in accordance with the following table:

Averaging period	Factor
37-48 months	1.55 percent
49-60 months	1.60 percent
61-120 months	1.75 percent
Over 120 months	2.00 percent

.02 Formulas using fractional accrual rule.

A defined benefit retirement system that calculates benefits based on a pro rata accrual towards a projected normal retirement benefit may meet the minimum retirement benefit requirement in the same manner as provided in section 3.01(l) provided the projected normal retirement benefit under the plan formula is greater than or equal to the benefit described in such section.

.03 Additional requirements for defined benefit plan formulas to meet safe harbors.

(1) Calculation of compensation.

(a) To meet the requirements of any of the defined benefit safe harbor formulas for plan years beginning after July 1, 1991, a retirement system must calculate benefits based on a definition of compensation that meets the requirements of section 31.3121(b)(7)-2(e)(2)(iii)(B) of the regulations.

(b) In the event that the definition of compensation under the retirement system is less inclusive than the definition otherwise permitted under this section, the applicable benefit percentage in the safe harbor formula of section 3.01 must be increased to account for the lower compensation base. The benefit percentage for employees in a retirement system whose benefits are computed using this definition must be multiplied by the ratio of (i) aggregate compensation (defined as under section 3.03(l)(a) and assuming that compensation considered in determining retirement benefits is limited to the contribution base described in section 3121(x)(1)) of these employees to (ii) aggregate compensation (as defined under the plan) of these employees. This ratio may be determined based upon the compensation during the immediately preceding plan year. In the case of a retirement system sponsored by more than one employer, this ratio must be calculated separately

with respect to the employees of each employer whose benefits are computed using this definition. The rule in this section 3.03(l)(b) is illustrated by the following example: Example. A defined benefit retirement system maintained by a political subdivision provides a retirement benefit equal to 2.5 percent of a participant's average compensation during his or her last calendar year of service. The compensation used for this purpose satisfies section 3.03(l)(a), except that it caps the compensation taken into account at \$30,000. Assume that the ratio under section 3.03(t)(b) is 150 percent. This figure is derived by comparing the total compensation of employees in the plan (using the plan definition but capping compensation at the FICA contribution base (rather than at \$30,000)) to the total compensation (using only the plan definition of compensation) of employees in the plan. The retirement system meets the requirements of 3.03(l) because the plan benefit percentage of 2.5 percent is more than 150 percent of the applicable safe harbor benefit percentage of 1.5 percent.

(2) Credited service.

(a) In order to meet the requirements of any of the defined benefit safe harbor formulas, a formula must generally include in credited service the employee's entire period of actual service with the employer since commencing participation in the retirement system, plus any past service credited under the retirement system. A formula may, however, exclude any periods of actual service for the employer that are treated as employment under section 3121(b) of the Code, provided that during such periods the employee did not participate in the retirement system. A retirement system subject to paragraph (f)(2)(i)(B) of section 31.3121(b)(7)-2 of the regulations (relating to the treatment of benefits accrued in plan years beginning prior to January 1, 1993) may also limit service consistent with the rules contained in that paragraph.

(b) A formula may limit the maximum period of service that is credited for accrual purposes under this rule. If this limit is less than 30 years in the case of formulas described in section 3.01(l) or (2), or 35 years in the case of formulas described in section 3.02, however, the benefit formula must be increased by the ratio of 30 (or 35) years to such lower limit.

(c) Except as provided in section 3.03(4) with respect to part-time and other classes of employees, a formula may limit the periods of actual service actually credited for accrual purposes under this rule to whole years or similar periods, provided the periods are reasonable.

(d) The rules in this subsection are illustrated by the following example:

Example. In 1995, an employee is a participant in a retirement system with 5 years of credited service. Assume that the retirement system provides benefits under a formula described in section 3.01. In January 1996, the employee moves to a position that is not covered by the retirement system. Assume that service in the new position constitutes covered employment under section 3121(b) of the Code for purposes of the FICA (e.g., because a section 218 voluntary agreement is in effect with regard to such position). In January 1998, the employee returns to the old position and recommences participation under the retirement system. The employee must be treated as being in the employee's sixth year of credited service in determining whether the benefit under the retirement system meets the minimum retirement benefit requirement. This is because the retirement

system may generally disregard the service of an employee that constitutes employment under section 3121(b) for purposes of the FICA.

(3) Treatment of prior distributions from the retirement system.

In determining whether the requirements of any of the defined benefit safe harbor formulas are met, prior distributions may continue to be considered as part of the benefit accrued under the retirement system unless they were distributed by the employer without any election by the employee. In addition, if a retirement system gives a former employee credit for benefit determination purposes for periods of prior service with respect to which a prior distribution was made only if the employee contributes to the system an amount equal to all or a portion of the prior distribution (with or without interest), and this option is provided on reasonable terms, such prior service is not required to be taken into account in determining whether the requirements of any of the defined benefit safe harbors are met until the required contribution is actually made. If prior service is not taken into account under this rule, the prior distribution may not be taken into account either. The rules of this paragraph is illustrated by the following example:

Example. An employee retires under the early retirement option under a retirement system maintained by a state government. The employee elects to receive a single sum distribution representing the entire accrued benefit under the plan. Subsequently, the employee is rehired by the same employer. The plan does not provide for any recontribution of the prior distribution. Whether the employee is a member of the retirement system from which the employee received the distribution is determined without regard to the single sum distribution. That is, a single life annuity that is the actuarial equivalent of the single sum may be treated as part of the accrued benefit under the plan. Similarly, all periods of service credited under the plan during the employee's previous service must be considered.

(4) Credited service for part-time, seasonal, and temporary employees.

To meet the requirements of any of the defined benefit safe harbor formulas with respect to a part-time, seasonal or temporary employee for plan years beginning after December 31, 1992, a safe harbor formula may not permit double proration of the employee's benefits under the retirement system. See 29 CFR §2530.204-2(d) for a description of double proration of benefit accruals. Under this rule, the benefit under the retirement system may be prorated either on the basis of full-time service or on the basis of full-time compensation, but may not be prorated based on both service and compensation. In addition, a safe harbor formula may not subject the crediting of service used in calculating the benefit of any part-time, seasonal or temporary employee to any conditions, such as a requirement that the employee attain a minimum age, perform a minimum period of service, be credited with a minimum number of hours of service, make an election in order to participate, or be present at the end of the plan year. The requirements of this section 3.03(4) will be deemed met with respect to an employee, however, if the requirements of section 31.3121(b)(7)-2(d)(2)(ii) of the regulations relating to amounts distributable upon certain events are met with respect to such employee. See section 31.3121(b)(7)-2(d)(2)(iii) of the regulations for the definitions of part-time, seasonal, and temporary employee for this purpose.

.04 Examples of application of safe harbor formulas.

The application of the defined benefit safe harbors are illustrated in the following examples:

Example 1. An employee has been a participant in a state retirement system for 9 years and several months at the beginning of a plan year of the system. The employee has only 9 years of credited service under the system at the beginning of the plan year, however, because the retirement system calculates service for accrual purposes on the basis of whole years of actual service. Under the retirement system, each participant is credited with a retirement benefit based upon the participant's highest average compensation over 36 consecutive months times his or her years of service (as so determined). Assume the retirement system imposes no other conditions on the accrual of benefits and meets the service crediting requirements of section 3.03(2). If at all times during the plan year prior to being credited with a tenth year of service the employee has a total accrued benefit of at least 13.5 percent of his or her highest average compensation (1.5 percent times 9 years), and at all times during the plan year after being credited with the tenth year of service the employee has a total accrued benefit of at least 15 percent of his or her highest average compensation (1.5 percent times 10 years), and the retirement otherwise meets the requirements of this revenue procedure and the regulations, the employee will be treated as a qualified participant throughout the plan year. This analysis applies without regard to whether the participant actually accrues a benefit in the plan year or is credited with an additional year of service for accrual purposes (e.g., if future accruals under the plan have been frozen or if the participant has obtained the maximum level of benefits under the plan).

Example 2. Assume the same facts as in Example 1, except that the plan grants 1 month of credited service for every whole month of actual service, and that the employee had 111 months of service (9 years and 3 months) at the beginning of the plan year. If at all times during the first month of the plan year prior to being credited with the 112th month of service the employee has a total accrued benefit of at least 13.875 percent of his highest average compensation (1.5 percent times 111 months, divided by 12), and at all times during the first month of the plan year after being credited with the 112th month of service the employee has a total accrued benefit of at least 14 percent of his highest average compensation (1.5 percent times 112 months, divided by 12), and the retirement system otherwise meets the requirements of this revenue procedure and section 31.3121(b)(7)-2(e) of the regulations, the participant is a qualified participant in the plan within the meaning of section 31.3121(b)(7)-2(d)(1) for the entire first month of the plan year.

Example 3. Assume the same facts as in Example 1, except that, instead of crediting only whole years of participation for accrual purposes, the retirement system credits only service during plan years in which a participant has at least 1,000 hours of service. Thus, as in Example 1, the participant has 9 years of credited service at the beginning of the plan year. If at all times during the plan year prior to meeting the 1,000-hour requirement the employee has a total accrued benefit of at least 13.5 percent of his or her highest average compensation (1.5 percent times 9 years), and at all times during the plan year after meeting the 1,000-hour requirement the employee has a total accrued benefit of at least 15 percent of his or her highest average compensation (1.5 percent times 10 years), the employee will be treated as a qualified participant in the retirement system within the meaning of section 31.3121(b)(7)-2(d)(1) of the regulations throughout the plan year.

## SECTION 4. DEFINED BENEFIT RETIREMENT SYSTEMS WITH BENEFIT FORMULAS NOT DESCRIBED IN THE SAFE HARBORS OF SECTION 3

### .01 In general.

A defined benefit retirement system that calculates benefits under a formula that does not meet one of the safe harbor formulas described in section 3 of this revenue procedure meets the minimum retirement benefit requirement with respect to an employee if the employee's accrued benefit as of the date of the determination is at least as great as the accrued benefit the employee would have if his or her accrued benefit had been calculated under the safe harbor formula in section 3.01(1). In determining whether this requirement is satisfied, the additional requirements set forth in section 3.03 must be taken into account. The rules in this paragraph are illustrated by the following example: Example. A defined benefit plan maintained by a political subdivision and described in section 457(b) of the Code provides only for single sum distributions and thus does not meet the requirements of any of the defined benefit safe harbor formulas. The plan may still meet the minimum retirement benefit requirement with respect to an employee if it provides a single sum with respect to such employee that is the actuarial equivalent (using reasonable actuarial assumptions) of a single life annuity meeting the requirements of section 3.01(1).

### .02 Treatment of past service credit.

In determining whether an employee's accrued benefit under a defined benefit retirement system that calculates benefits under a formula that does not meet one of the defined benefit safe harbor formulas is at least as great as the accrued benefit the employee would have if his or her accrued benefit had been calculated under the safe harbor formula in section 3.01(1), a retirement system may ignore periods of service by an employee with the employer prior to his or her commencement of participation in the retirement system, notwithstanding the additional rules relating to credited service in section 3.03(2). If such periods of service are ignored, however, any accrued benefits attributable to such period of service must also be ignored. The rule in this paragraph is illustrated by the following example:

Example: An employee begins to participate in a retirement system in the employee's fifth year of service. The retirement system provides credit for all past service with the employer. Assume the retirement system does not provide benefits under a formula that meets the requirements of any of the safe harbors. The employee must be treated as being in the employee's fifth year of credited service if benefits attributable to the past service are to be taken into account in comparing the benefit under the retirement system to the benefit the employee would have under the safe harbor formula of section 3.01(1) to determine whether the minimum retirement benefit requirement is met.

## SECTION 5. EMPLOYEES WITH MULTIPLE POSITIONS OR WHO PARTICIPATE IN CERTAIN RETIREMENT SYSTEMS

See section 31.3121(b)(7)-2(e)(2)(iv) and (v) of the regulations for rules to be used in determining the service, compensation and benefits taken into account for purposes of this revenue procedure in the case of employees who are employed in more than one position with the employer, and employees who are participants in retirement systems maintained by more than one employer, respectively.

## SECTION 6. EFFECTIVE DATE

This revenue procedure is effective with respect to service performed after July 1, 1991.

## Revenue Ruling 2000-6

*Section 6041.--Information at Source.*

*26 CFR 1.6041-2: Return of information as to payments to employees.*

*(Also Part 1, Sections 3121, 3401, 6051); (Also 1.6041-1)*

### ISSUE

How do the information reporting requirements of sections 6041(a) and 6051(a) of the Internal Revenue Code apply to election workers?

### FACTS

Election workers are individuals who are generally employed to perform services for state and local governments (governments) at election booths in connection with national, state, or local elections. Governments typically pay election workers a set fee for each day of work. Election workers' wages are includible in gross income as compensation for services. Section 61(a)(1). An individual employed as an election worker may also perform services for the government in another capacity.

A state and the Social Security Administration may agree to extend social security coverage to services of employees of the state or its political subdivisions under section 218 of the Social Security Act (section 218 agreement). A section 218 agreement may cover the services of election workers. If so, the section 218 agreement may specify the level of fees the election workers must receive to be entitled to coverage. Information about a state's section 218 agreement can be obtained from the State Social Security Administrator.

Situation 1: Government A pays V \$200 in a calendar year for services as an election worker. A does not employ V in any other capacity. The services of A's election workers are not covered by a section 218 agreement. V is not covered by a retirement plan maintained by A.

Situation 2: Government B pays W \$200 in a calendar year for services as an election worker. B does not employ W in any other capacity. The services of B's election workers are covered by a section 218 agreement if their remuneration is \$100 or more in a calendar year. W is not covered by a retirement plan maintained by B.

Situation 3: Government C pays X \$1,100 in calendar year 2000 for services as an election worker. C does not employ X in any other capacity. The services of C's election workers are not covered by a section 218 agreement. X is not covered by a retirement plan maintained by C.

Situation 4: Government D pays Y \$200 in a calendar year for services as an election worker. D also employed Y in another capacity, in which Y earned wages of \$300 that are subject to income tax withholding. The services of D's election workers are not covered by a section 218 agreement. Y is not covered by a retirement plan maintained by D.

Situation 5: Government E pays Z \$ 200 in a calendar year for services as an election worker. E also employed Z in another capacity, in which Z earned wages of \$500 that are subject to income tax withholding. The services of E's election workers are not covered by a section 218 agreement. Z is not covered by a retirement plan maintained by E.

### LAW



Taxes under the Federal Insurance Contribution Act (FICA) apply to "wages" as defined in section 3121(a). That section provides that the term wages includes only remuneration for "employment." Section 3121(b)(7)(F)(iv) provides that the services of an election worker are not employment for FICA purposes if the worker's remuneration is less than \$1,000. For calendar years beginning on or after January 1, 2000, the amount is indexed for inflation. The applicable amount for the year 2000 is \$1,100. Because service performed by an election worker for calendar year 2000 for an amount less than \$1,100 is excluded from employment for FICA purposes, that amount is not wages for FICA purposes unless covered under a section 218 agreement.

Similarly, section 3121(u)(2)(B)(ii)(V) provides that the services of an election worker are not employment for purposes of the Medicare tax portion of the FICA if the worker's remuneration is less than \$1,000 in a calendar year. For calendar years beginning on or after January 1, 2000, the amount is indexed for inflation. The applicable amount for the year 2000 is \$1,100. For services performed before January 1, 1995, the section 3121(u)(2)(B)(ii)(V) exclusion was for remuneration of less than \$100. Rev. Rul. 88-36, 1988-1 C.B. 343, A2, provides that an election worker is subject to Medicare tax unless the remuneration paid to the worker in a calendar year is less than \$100.

Section 3401(a) provides that, for purposes of income tax withholding, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for an employer. Section 31.3401(a)-2(b)(2) of the Employment Tax Regulations states that amounts paid to precinct workers for services performed at election booths are "in the nature of fees paid to public officials" and not subject to income tax withholding.

Sections 6041(a) and 6051(a) both impose a duty to file information reports of compensation paid to workers.

Section 6041(a) provides:

All persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income ... of \$600 or more in any taxable year ... shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Under section 1.6041-1(b)(1) of the Income Tax Regulations, the term "all persons engaged in a trade or business," as used in section 6041(a), includes organizations the activities of which are not for the purpose of gain or profit.

The general rule stated in section 1.6041-1(a)(2) is that the required return is made on Forms 1096 and 1099, except that section 1.6041-1(a)(2)(ii) provides that compensation paid to an employee by an employer shall be reported on Forms W-3 and W-2 under the provisions of section 1.6041-2 (relating to return of information as to payments to employees).

Under section 1.6041-2(a)(1), payments of wages not subject to income tax withholding must be reported on Form W-2 if the total of those payments and the amount of the employee's wages subject to income tax withholding, if any, is \$600 or more in a calendar year. For example, if a payment of \$700 was made to an employee and \$400 thereof represents wages subject to withholding under section 3402 and the remaining \$

300 represents compensation not subject to withholding, such wages and compensation must both be reported on Form W-2. If the employee has no wages subject to income tax withholding, the employer is required to file Form W-2 for that employee if payments to that employee equal \$600 or more in a calendar year.

Section 1.6041-2(a)(1) provides that, at the election of the employer, components of amounts required to be reported on Form W-2 pursuant to this subparagraph may be reported on more than one Form W-2. Thus the amounts paid to an individual for services as an election worker may be reported on a separate W-2 from amounts paid to the individual for service in another capacity, even though the amounts are aggregated to determine whether reporting applies.

Section 6051(a) imposes a reporting requirement on the following two categories of payors of remuneration:

Every person required to deduct and withhold from an employee a tax under section 3101 [employee FICA tax] or 3402 [income tax withholding], ...or every employer engaged in a trade or business who pays remuneration for services performed by an employee ....

Section 6051(a) does not require reporting of compensation that is not subject to withholding of FICA tax or income tax.

Section 6051(c) provides that the Secretary may prescribe by regulations the reporting of additional items. No regulations requiring employers to furnish additional information have been published.

#### ANALYSIS

Compensation of an election worker is not subject to income tax withholding. Sections 3401(a) and 31.3401(a)-2(b)(2). If an election worker's compensation is less than \$1,100 for calendar year 2000, it is generally not subject to FICA tax. Sections 3121(b)(7)(F)(iv) and 3121(u)(2)(B)(ii)(V). However, under a state's section 218 agreement, an election worker's compensation may be subject to both the old-age, survivors and disability insurance (OASDI) and the Medicare portions of the FICA tax at a level below \$1,100 for calendar year 2000.

Section 6041(a) applies to payments of compensation that are not subject to withholding of FICA or income tax. If an election worker's compensation is not subject to withholding of FICA tax, the section 6041(a) reporting requirement applies to payments that aggregate \$600 or more in any taxable year. Under section 1.6041-2(a)(1), compensation subject to income tax withholding is taken into account in determining whether the \$600 reporting requirement applies.

Section 6051(a) requires reporting of compensation subject to either FICA tax or income tax withholding. No reporting is required by sections 6051(a) and 31.6051-1(a) and (b) for items of income that are not subject to withholding of FICA tax or income tax. If an election worker's compensation is subject to withholding of FICA tax, reporting is required by section 6051(a), regardless of the amount of compensation.

#### HOLDINGS

The reporting requirements applicable to governments that employ election workers are as follows:

Situation 1: Neither FICA tax nor income tax withholding applies to the \$200 paid to V. The reporting requirements of section 6041(a) apply. Because V earns fees that are less than \$600, Government A is not required to issue Form W-2 to V.

Situation 2: FICA tax, but not income tax withholding, applies to the \$200 paid to W because the fees exceed the \$100 threshold in the section 218 agreement. Government B must follow the reporting requirements of section 6051(a), reporting on Form W-2 the fees of \$200 and the FICA tax withheld.

Situation 3: FICA tax, but not income tax withholding, applies to the \$1,100 paid to X for calendar year 2000. Government C must follow the reporting requirements of section 6051(a), reporting on Form W-2 the fees of \$1,100 and the FICA tax withheld.

Situation 4: Neither FICA tax nor income tax withholding applies to the \$200 paid to Y for services as an election worker, but the \$300 payment is subject to income tax withholding. Government D must follow the reporting requirements of section 6051(a), reporting on Form W-2 the \$300 payment and the income tax withheld. Section 6041(a) does not require reporting of the \$200 payment because the total of the two payments is less than \$600 for the calendar year.

Situation 5: Neither FICA tax nor income tax withholding applies to the \$200 paid to Z for services as an election worker, but the \$500 payment is subject to income tax withholding. Government E must follow the reporting requirements of sections 6041(a) and 6051(a), reporting on Form W-2 both the \$200 and the \$500 payments and the amount of income tax withheld.

#### EFFECT ON OTHER REVENUE RULING(S)

This ruling modifies Rev. Rul. 88-36, A2, to reflect the increase in the amount of remuneration applicable for purposes of the Medicare tax exclusion under section 3121(u)(2)(B)(ii)(V), currently \$1,100 for calendar year 2000.

DRAFTING INFORMATION

## Notice 2000-38

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### I. Purpose And Scope

This notice describes the withholding and reporting requirements applicable to eligible deferred compensation plans described in section 457(b) of the Internal Revenue Code of 1986 ("section 457(b) plans").

Specifically, this notice addresses --

- income tax withholding and reporting with respect to annual deferrals made to a section 457(b) plan;
- income tax withholding and reporting with respect to distributions from a section 457(b) plan;
- Federal Insurance Contributions Act (FICA) payment and reporting with respect to annual deferrals under a section 457(b) plan;
- employer identification numbers (EINs) used in connection with trusts established under section 457(g); and
- the application of annual reporting requirements to section 457(b) plan administrators and trustees holding assets of a section 457(b) plan in accordance with section 457(g).

This notice addresses only reporting and withholding rules that apply to section 457(b) plan participants who are or were employees of state and local governments or tax-exempt organizations and does not cover special reporting rules that may apply to section 457(b) plan participants who are or were independent contractors.

### II. Background

Section 457 provides rules for nonqualified deferred compensation plans established by eligible employers. State and local governments and tax-exempt organizations are eligible employers. They can establish either eligible plans that meet the requirements of section 457(b) or plans that do not meet the requirements of section 457(b) and that are therefore subject to tax treatment under section 457(f).

Section 1448 of the Small Business Job Protection Act of 1996, ("SBJPA"), 1996-3 C.B. 155, 212, amended section 457 by adding section 457(g), which requires that section 457(b) plans maintained by state or local government employers hold all plan assets and income in trust, or in custodial accounts or annuity contracts described in section 401(f), for the exclusive benefit of participants and their beneficiaries. Section 457(g) applies generally to assets and income held by a governmental section 457(b) plan on and after August 20, 1996. However, with respect to a governmental section 457(b) plan in existence on August 20, 1996, a trust (or a custodial account or annuity contract) was not required to have been established before January 1, 1999. Section 457(g) does not apply to a section 457(b) plan established by a tax-exempt organization that is not a state or local governmental entity.

Notice 98-8, 1998-1 C.B. 355, provides guidance regarding the amendments made to section 457(b) by the SBJPA. Following publication of the 1998 notice, the Service received additional inquiries regarding the statutory changes made in section 457(b) by the SBJPA and the Taxpayer Relief Act of 1997, Pub. L. No. 105-34. Specifically, taxpayers, employers, and plan administrators asked what employment and income tax reporting requirements apply with respect to section 457(b) plans and whether a trustee or administrator of a trust established under section 457(g) must file annual information returns relating to the trust, such as Form 990, Return of Organization Exempt From Income Tax, or an appropriate version of Form 5500, Annual Return/Report of Employee Benefit Plan.

### **III. Income Tax Withholding And Reporting On Annual Deferrals**

Section 457(a) provides that annual deferrals under a section 457(b) plan and any income attributable to the amounts so deferred will not be includible in a participant's gross income until that amount is paid or made available to the participant or beneficiary. Therefore, annual deferrals under a section 457(b) plan are not subject to income tax withholding at the time of the deferral. However, a participant's annual deferrals during the taxable year under a section 457(b) plan are reported on Form W-2, Wage and Tax Statement, in the manner described in the instructions to that form. "Annual deferrals", as used in this notice, means the amount of compensation deferred under the plan in accordance with section 457(b) whether by salary reduction or nonelective employer contribution, during a taxable year.

### **IV. Income Tax Withholding On Section 457(b) Plan Distributions**

#### **A. Income Tax Withholding On Section 457(b) Plan Distributions**

"Distributions" from a section 457(b) plan to a participant or former participant include all amounts that are paid or made available under a section 457(b) plan. Distributions to a participant or former participant from a section 457(b) plan are wages under section 3401(a) that are subject to income tax withholding in accordance with the income tax withholding requirements of section 3402(a). The pension withholding rules of section 3405 do not apply. See section 35.3405-1, a-23, Q&A of the Temporary Employment Tax and Collection of Income Tax at Source Regulations.

Income tax withholding on distributions to a participant or former participant under a section 457(b) plan is calculated in the same manner as withholding on other types of wage payments. For guidance on the use of the flat rate withholding method as a supplement to regular wage withholding in cases where the payor is paying wages to the participant in addition to the distribution from the section 457(b) plan, see section 31.3402(g)-1(a) of the Employment Tax Regulations and Rev. Rul. 82-46, 1982-1 CB 158. If an eligible payor uses the flat rate of withholding as an alternative to regular wage withholding on a lump sum payment, section 13273 of the Omnibus Budget Reconciliation Act of 1993, 1993-3 C.B.1, 130 provides that a 28 percent flat rate must be used.

#### **B. Person Responsible For Income Tax Withholding On Distributions**

Section 3402(a) requires every employer making payment of wages to withhold income tax on these wages. However, section 3401(d)(1) provides that if the person for whom an individual performed services as an employee does not have control of the payment of the wages for those services, the person having control of the payment of the wages is responsible for income tax withholding on those wages. See section 31.3401(d)-1(f). Thus, if distributions are made by a section 457(g) trustee of a plan established by a state or local government, the trustee is responsible for income tax withholding and reporting on the distributions. Similarly, if distributions are made by a section 457(g) custodian or insurance carrier treated as a trustee under section 457(g), the custodian or insurance carrier is responsible for income tax withholding on the distributions. Subsections C, D, and E of this Section IV provide additional information regarding how the trustee (or custodian or insurance carrier) should withhold, deposit, and report distributions. When distributions are made under a section 457(b) plan established by a tax-exempt organization, the tax-exempt organization or any other person having control of the payment of the distributions is responsible for income tax withholding on the distributions.

#### **C. Reporting On Form W-2 For Distributions From A Section 457(b) Plan**

Distributions to a participant or former participant during a taxable year under a section 457(b) plan are reported on Form W-2, Wage and Tax Statement, in the manner described in the instructions to that form. See also Rev. Rul. 82-46, *supra*. Income tax withheld from section 457(b) plan distributions is reported quarterly on Form 941, Employer's Quarterly Federal Tax Return.

#### **D. Reporting Death Benefit Payments**

Distributions to a beneficiary of a deceased participant under a section 457(b) plan are reported on Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. See Rev. Rul. 86-109, 1986-2 C.B. 196. No income tax withholding is required for distributions from section 457(b) plans to beneficiaries. See Rev. Rul. 59-64, 1959-1 C.B. 31. The instructions for Form 1099-R describe how this form is completed for distributions made to a beneficiary from a nonqualified deferred compensation plan, such as a section 457(b) plan.

#### **E. EINs and Income Tax Deposits With Respect To Section 457(g) Trust Accounts**

Generally, the income tax withheld on distributions should be reported on the Form 941 of the person responsible for withholding, as described in section IV-B of this notice, and aggregated with other amounts reported by that person on Form 941 to determine the frequency of federal tax deposits under section 31.6302-1. This is the same as the first alternative described in Announcement 84-40, 1984-17 IRB 31. Alternatively, the IRS will permit trustees of section 457(g) trusts, or custodians or insurance carriers treated as trustees under section 457(g)(3) to use the other two alternatives contained in Announcement 84-40 for the tax administration of such withholdings:

1. The trustee, custodian, or insurance carrier may request an EIN solely for the purpose of reporting the aggregated withholding from the distributions of every section 457(g) trust, custodial account, or annuity contract under its control, making deposits and filing Form 941 accordingly.

2. The trustee, custodian, or insurance carrier may request and use a separate EIN for each section 457(g) trust (or custodial account or insurance contract), making deposits and filing Form 941 accordingly.

The trustee, custodian, or insurance carrier exercising any of the above alternatives for depositing and reporting the tax withheld from section 457(g) trust distributions must also follow the same option in filing the related information returns, such as Forms W-2 (in the case of distributions to participants or former participants) or 1099-R (in the case of distributions to beneficiaries). That is, the trustee, custodian, or insurance carrier must use the same name and EIN on Forms W-2 or 1099-R as that under which the tax was deposited and the quarterly return filed. The trustee, custodian, or insurance carrier must aggregate and deposit all taxes pursuant to section 31.6302-1 under the EIN chosen. The above-described options relate only to trusts, annuity contracts or custodial accounts established pursuant to section 457(g) for amounts deferred under section 457(a). For information on the remittance of social security, Medicare, and FUTA taxes by the employer, see section V-D below.

## **V. FICA and FUTA Taxes And Reporting**

### **A. Scope**

The rules described in this notice relating to FICA (social security and Medicare) tax apply to employees of state and local governments only if they are subject to social security or Medicare tax under section 3121(u) (relating to Medicare), section 3121(b)(7)(E) (relating to agreements entered into pursuant to section 218 of the Social Security Act), or other provisions of the Code, such as section 3121(b)(7)(F) (relating to state and local government employees who are not members of a state or local retirement system). The FICA rules discussed in this notice generally apply to employees of tax-exempt organizations, unless a specific exclusion is applicable. The FICA tax discussed in this Section V includes the employer's share of the FICA tax imposed under section 3111 as well as the employee's share imposed under sections 3101 and 3102.

The rules described in this notice relating to the Federal Unemployment Tax Act (FUTA) do not apply to service for a state or local governmental entity because section 3306(c)(7) provides a FUTA exemption for service performed in the employ of a state or any political subdivision thereof or any instrumentality of any one or more of the foregoing. The rules described in this notice relating to FUTA apply to service for a tax-exempt organization other than a tax-exempt organization described in section 501(c)(3). See section 3306(c)(8).

### **B. Time Social Security, Medicare, And FUTA Taxes Imposed**

Sections 3121(a) (relating to social security and Medicare) and 3306(b) (relating to FUTA) define "wages" as all remuneration for employment, unless specifically excluded (see section V-A, above). If social security, Medicare, or FUTA taxes apply, sections 3121(v)(2) and 3306(r)(2) contain special timing rules that apply in determining when amounts deferred under a nonqualified deferred compensation plan are required to be taken into account. Under these sections, an amount deferred under a nonqualified deferred compensation plan, including a section 457(b) plan, is required to be taken into account for purposes of social security, Medicare, and FUTA taxes as of the later of when the services are performed or when there is no substantial risk of forfeiture of the rights to such amount.

Thus, if a section 457(b) plan provides that annual deferrals are fully and immediately vested, annual deferrals are subject to social security, Medicare, and FUTA taxes at the time of deferral. However, if the annual deferrals are not fully and immediately vested, but are subject to a substantial risk of forfeiture, the annual deferrals (and earnings thereon) are generally taken into account for purposes of social security, Medicare, and FUTA at the time such amounts are no longer subject to a substantial risk of forfeiture. For purposes of social security, Medicare, and FUTA taxes, the determination of whether a substantial risk of forfeiture exists is made in accordance with the principles of section 83 and the regulations thereunder. See sections 31.3121(v)(2)-1(e)(3) and 31.3306(r)(2)-1.

If amounts deferred under a section 457(b) plan are properly taken into account as social security, Medicare, and FUTA wages when deferred (or, if later, when they cease to be subject to a substantial risk of forfeiture), the amounts subsequently paid or made available to a participant or beneficiary under the section 457(b) plan are not subject to social security, Medicare, or FUTA taxes. See sections 3121(v)(2)(B) and 3306(r)(2)(B) and sections 31.3121(v)(2)-1(a)(2)(iii) and 31.3121(v)(2)-1(d)(2). If an amount deferred for a period is not properly taken into account, distributions attributable to that amount, including income on the amounts deferred, may be wages for FICA purposes when paid or made available. See section 31.3121(v)(2)-1(d)(1)(ii). Additional special rules apply to section 457(b) plans other than plans where benefits are based on a participant's account balance. See section 31.3121(v)(2)-1(e)(4).

### **C. Examples**

The application of social security and Medicare tax is illustrated by the following examples:

**Example 1.** (i) State R's section 457(b) plan provides for elective deferrals from current salary, as well as a one percent of salary nonelective contribution for each employee who participates in the plan and who is employed with State R during the plan year. All employees who participate in the plan are covered by an agreement under section 218 of the Social Security Act. All deferrals and contributions, including the state's contribution, are fully and immediately vested.

(ii) Because these contributions are not subject to a substantial risk of forfeiture (and the services to which they relate have already been performed), the elective deferrals are required to be taken into account as wages at the time of the deferral and State R's nonelective contribution is required to be taken into account as wages at the time of the contribution for purposes of the social security and Medicare tax.

**Example 2.** (i) Assume the same facts as in Example 1, except that the plan has three-year vesting for State R's nonelective contribution. Therefore, an employee's rights to the nonelective contributions (and the associated earnings) are subject to a substantial risk of forfeiture until the employee has been employed by State R for three years.

(ii) State R's nonelective contributions (and earnings thereon) are not wages for purposes of the social security and Medicare tax until the



employee has completed three years of service. At that time, the aggregate amount of State R's nonelective contributions, plus earnings thereon, is required to be taken into account as wages for purposes of the social security and Medicare tax. Once an individual has met the vesting requirements, future nonelective contributions by State R are required to be taken into account as wages for purposes of the social security and Medicare tax at the time of the contribution.

#### **D. Deposit And Reporting Of Social Security, Medicare And FUTA Taxes**

The employer must aggregate and deposit social security and Medicare taxes associated with a section 457(b) plan (including the employer's share of social security and Medicare taxes under section 3111) with all other social security, and Medicare taxes and withheld income taxes paid on behalf of its employees in accordance with section 31.6302-1 and must report these taxes on Form 941. Employers subject to FUTA must aggregate and deposit FUTA amounts associated with a section 457(b) plan with all other FUTA amounts paid on behalf of its employees in accordance with section 31.6302(c)-3 and must report these payments on Form 940.

### **VI. Annual Reporting For Section 457 Plans**

#### **A. Section 457(b) Plans Of Tax-Exempt Organizations**

Annual deferrals and payments to certain participants in a section 457(b) plan of a tax-exempt organization are reported on the organization's Form 990 in the manner described in the instructions to that form.

#### **B. Section 457(g) Trusts**

A trust described in section 457(g) is not required to file Form 990, Return of Organization Exempt From Income Tax, Form 1041, U.S. Income Tax Return for Estates and Trusts, Form 1120, U.S. Corporation Income Tax Return, or Form 5500, Annual Return/Report of Employee Benefits Plans. See, for example, Rev. Proc. 95-48, 1995-2 C.B. 418, which provides that governmental units and affiliates of governmental units that are exempt from federal income tax under section 501(a) are not required to file annual information returns on Form 990, Return of Organization Exempt From Income Tax. A trust described in section 457(g) may be required to file Form 990-T, Exempt Organization Business Income Tax Return. See sections 1.6012- 2(e) and 1.6012-3(a)(5) for the requirements for filing Form 990-T.

### **VII. Other Information Available**

Further information regarding the reporting, payment and deposit of employment taxes such as social security, Medicare, FUTA, and withheld income tax can be found in Publication 15, Circular E, Employer's Tax Guide; Publication 15-A, Employer's Supplemental Tax Guide; and Publication 963, Federal-State Reference Guide: Social Security Coverage and FICA Reporting by State and Local Government Employers. These publications will be revised, as appropriate, to reflect the proper treatment of trusts under section 457(g).

**VIII. Effective Date**

This notice is applicable with respect to deferrals and distributions made after December 31, 2001. Plan sponsors, plan administrators and taxpayers may rely on this Notice for distributions and deferrals before January 1, 2002.



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Additional copies of the  
Federal-State Reference  
Guide can be ordered by  
calling the IRS at  
1-800-829-3676.



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