FEDERAL-STATE REFERENCE GUIDE

Social Security Coverage and FICA Reporting by State and Local Government Employers

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Preface

■ Objectives of this book

The ***Federal-State Reference Guide*** is written to provide State and local government employers a comprehensive reference source for Social Security and Medicare coverage and Federal Insurance Contributions Act (FICA) tax withholding issues.

■ Changes in the 1997 edition

In addition to updating and clarifying the text and references, the 1997 edition has been updated as follows:

- Chapter 3 (Determining Worker Status) was completely rewritten.

- The 1995 edition contained 12 chapters. The 1997 edition delivers 13 chapters. The Social Security benefits section, previously located in Chapter 10 of the 1995 edition, has been expanded and moved to the new Chapter 11 in the 1997 edition. Chapter 11 also contains information on Medicare benefits and provides an expanded discussion on government pension offset and the windfall elimination provision.

- Exhibits of IRS Revenue Rulings 86-88 and 88-36 and IRS Revenue Procedure 91-40 were added to the Appendix. Exhibits of Sections 209 and 210 of the Social Security Act were deleted.

The 1997 edition of the ***Federal-State Reference Guide*** supersedes the first edition of the Federal-State Reference Guide issued in July 1995. The first edition was a cooperative effort between 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.

The ***Federal-State Reference Guide*** is for informational and reference purposes. Under no circumstances, should the contents of this Guide 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, Social Security Act and related regulations, rulings and case law are the only valid citations of authority for technical matters.

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Introduction

Introduction

Social Security and Medicare hospital insurance (HI) coverage and tax/withholding requirements for State and local government employees are unique. The Social Security and Medicare coverage required of public employers, therefore, vary from those of private employers due to the historical development of the law.

Historical Overview — State And Local Social Security

When initially enacted in 1935, the *Social Security Act* (Act) did not include public employees as eligible for Social Security because of the Constitutional question regarding the power of the Federal government to tax State and local governments. Because many government employers did not have their own retirement systems, in 1950 the United States Congress amended the Act to allow States to voluntarily enter into agreements with the Social Security Administration (SSA), on behalf of the Department of Health and Human Services. This permitted a State to provide Social Security coverage for its employees or employees of political subdivisions within the State. Each State designated an official to administer the agreement on behalf of the State. This official is referred to as the State Social Security Administrator. These agreements are often called "Section 218 Agreements" because they are authorized by Section 218 of the Act. Social Security coverage was not mandated by the Federal government at that time.

Subsequently, 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; and mandatory Social Security and Medicare coverage for State and local government employees not covered by a public retirement system or covered under a Section 218 Agreement (effective July 2, 1991).

Key Dates. Significant dates associated with State and local coverage are:

1. **1951.** States could voluntarily elect Social Security coverage for their public employees not covered under a public retirement system by entering into a Federal-State Agreement with SSA through their State Social Security Administrator. Beginning in 1955, employees under a public retirement system could also be covered under both Social Security and the public retirement system.
2. **April 20, 1983.** Prior to this date, States were permitted to terminate the coverage of any or all groups of employees listed in the State's agreement. Since April 20, 1983, coverage under a Section 218 Agreement cannot be terminated (unless the entity is legally dissolved). Therefore, if a public employer is covered under a Section 218 agreement and later joins a public retirement system (that is not covered by a Section 218 Agreement), Social Security coverage under the agreement must continue.
3. **April 1, 1986.** All employees hired after March 31, 1986 are mandatorily covered for Medicare HI-only, unless specifically excluded by law. Employees covered by Social Security are covered by Medicare.
4. **January 1, 1987.** State Social Security Administrators were no longer responsible for collecting Social Security contributions from public employers in their States and no longer had liability 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). FICA taxes include the Social Security and Medicare taxes imposed on employers and employees. 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. Additionally, State Social Security Administrators were responsible for ensuring that State/local government employers filed timely and accurate returns, and that the proper amounts of Social Security taxes were collected from public employers and paid to the Federal government.
5. **July 2, 1991.** All State and local government employees, with certain exceptions, who **are not** (1) covered by a public retirement system, or (2) covered under a Section 218 Agreement are subject to mandatory Social Security and Medicare coverage.

6. **August 15, 1994.** *Social Security Independence and Program Improvements Act of 1994* was signed. In addition to establishing the Social Security Administration 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 $1,000 in a calendar year. It also amended Section 218 of the Act to authorize all States the option to extend Social Security coverage to police officers and firefighters who participate in a public retirement system. (Under previous law, only 24 States were specifically authorized.)

Public Versus Private Employers' FICA Responsibilities

Since the early 1980's significant changes have been made to several major Federal laws, including the *Social Security Act* (Act) and *Internal Revenue Code* (IRC), especially as they relate to State and local government employers. At the same time, the roles and responsibilities of the Federal government (SSA and IRS) and State governments (as State Administrators of Social Security programs) have changed.

Social Security coverage of State and local employees involves a complex set of laws and regulations that provide exceptions for unique 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 1981, 1986, 1990 and so forth.

Important Considerations

- Do not assume you know the entity's FICA status (Section 218/non-Section 218 coverage), and, therefore, whether it is in compliance with all applicable laws or not, merely because you know the status of a similar entity either in the same or a different State.

- Section 218 Agreements:

    1. When the State entered into a Section 218 Agreement to elect voluntary Social Security coverage for the particular political subdivision, what optional exclusions, and what "coverage groups" were listed in that agreement?

    2. Did the State or political subdivision opt out of 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 the particular entity?

- Non-Section 218 coverage (Public Retirement Systems):

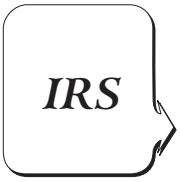
    1. Does the State or political subdivision have any employees who were hired prior to April 1, 1986, and are exempt from contributing to mandatory Medicare?

    2. Does the State or political subdivision have a qualified public retirement system that excludes the coverage group from mandatory Social Security coverage (effective for public employers July 2, 1991)?

EDITOR'S NOTE: Throughout the Federal-State Reference Guide, whenever the term "qualified public retirement system" is used, the term refers to a retirement system of a State, political subdivision or instrumentality thereof that meets the qualification tests under section 3121(b)(7)(F) of the Internal Revenue Code. (See Revenue Procedure 91-40, Appendix A-25.)

Who Is Responsible for What?

Internal Revenue Service (IRS):



1. Administers the Internal Revenue Code (IRC), including the mandatory Social Security and Medicare provisions under FICA.
2. Establishes and enforces reporting requirements for Social Security and Medicare taxes.
3. Advises employers when to withhold and report FICA taxes.
4. Receives and processes Forms 941.
5. Audits and collects FICA taxes.
6. Defines/resolves employment tax liability issues.
7. Defines/resolves tax issues associated with:
   - payment of wages
   - employment including defining the term "New Hire"
   - employee-employer relationship
8. Advises SSA and State Administrator of tax issues; clarifies issues; and responds to questions from SSA, State Social Security Administrators and employers on tax matters.
9. Answers paper reporting questions from all employers.
10. Provides publications and forms required for reporting.

See Chapter 9, The Internal Revenue Service (IRS)

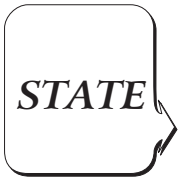
Social Security Administration (SSA):

1. Administers the Social Security Act, including interpreting its provisions.
2. Reviews and processes Section 218 Agreements and modifications (Federal-State agreements that govern voluntary Social Security coverage for public employees).
3. Interprets Section 218 Agreements and modifications.
4. Executes time limitation extension and reextension agreements.
5. Defines/resolves issues related to Social Security coverage and benefits, including but not limited to, defining wages for Social Security coverage purposes.
6. Determines the amount of wages placed on an individual's Social Security earnings record and corrects erroneously posted amounts, as required by law.
7. Provides information about Social Security programs and Medicare, as well as accepting claims for and determining entitlement to those programs.
8. Reviews Social Security/Medicare coverage, ensuring proper Social Security coverage and benefit payments.
9. Advises IRS and State Social Security Administrators regarding Social Security/Medicare issues.
10. Receives and processes Annual Wage Reports (Forms W-2/W-3 data) from employers.
11. Answers reporting questions from employers, whether filing via paper, magnetic media or electronically, and assists them in reporting correctly.
12. Assists employers with resubmission of reports that could not be processed because of format or content problems. Answers questions and serves as a liaison with the magnetic media processing library if a file is returned.

13. Processes, handles and assists employers with reconciliation of Form W-3 data with Form 941 totals.
14. Advises IRS, employers, reporters and State Social Security Administrators of reporting issues; clarifies issues; and responds to questions from IRS, employers, reporters and State Social Security Administrators on reporting issues.

See Chapter 8, The Social Security Administration (SSA)

State Social Security Administrators



Under Section 218 of the *Social Security Act* (Act), the only 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.

For Section 218 Agreement purposes, State Social Security Administrators:

1. Serve as a bridge between State and local government employers and Federal agencies such as SSA and IRS.
2. Administer/maintain the Federal-State Agreement (Section 218 Agreement) which governs voluntary Social Security coverage by State and local government employers in each State.
3. Prepare Section 218 modifications to include additional coverage groups, correct errors in other modifications, identify additional political subdivisions which join a covered retirement system, or obtain Medicare coverage for public employees whose employment relationship with a public employer has not terminated since March 31, 1986.
4. Provide SSA with notice and evidence of the legal dissolution of covered State or political subdivision entities.
5. Resolve coverage and taxation questions with SSA and IRS associated with the Section 218 Agreement and modifications.
6. Negotiate with SSA to resolve Social Security contribution payment and wage reporting questions concerning wages paid before 1987.
7. Advise the State's public employers of applicable Social Security/Medicare and tax withholding matters and how they affect them.
8. Provide information to State and local public employers as appropriate and in accordance with the State's enabling legislation, policies, procedures and standards.
9. Advise SSA and IRS of issues unique to the State, responding to Forms SSA-4500 for pre-1987 wage verification; provide advice on Federal-State optional exclusions applicable to the State and/or individual modifications; and provide advice on State and local laws/rules/regulations and compliance concerns.

See Chapter 7, The Role of the State Social Security Administrator

Public Employers:

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

See Chapter 10, Public Employers

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Frequently Asked Questions

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Questions & Answers

NOTES

Below are listed frequently asked questions and answers which highlights some of the main issues of public employees' Social Security and Medicare. Because of the complexity of the issues and unique circumstance of each entity, only a few general questions have been selected. Check the appropriate chapter(s) for more detailed information about specific questions.

1. What is a Section 218 Agreement?

SSA
STATE

A written voluntary agreement between the State and the Social Security Administration pursuant to the provisions of Section 218 of the Social Security Act *to provide Social Security and/or Medicare coverage for State and local government employees. The term refers to the original agreement and all subsequent modifications. To determine if 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 beginning on page 7-5.)*

2. What is a qualified public retirement system?

IRS

A qualified public retirement system is a retirement system maintained by a State, political subdivision or instrumentality thereof that meets the qualification test under section 3121(b)(7)(F) of the Internal Revenue Code. (See Revenue Procedure 91-40, Appendix A-25.)

3. What determines whether an organization is a public or private employer?

IRS
STATE

Contact IRS concerning the status of an entity for FICA purposes. Refer questions concerning the status of an entity for Section 218 purposes to the State Social Security Administrator.

4. Why don't all public employees pay Social Security and Medicare when all private employees are required to do so?

SSA

When initially enacted in 1935, the Social Security Act *did not cover public employees under Social Security because there was a Constitutional question regarding the power of the Federal government to tax State and local governments. Subsequently, because many government employers did not have their own retirement systems, in 1950 the United States Congress added Section 218 to the Social Security Act to allow States to voluntarily enter into agreements with the Social Security Administration (SSA) to permit coverage for some or all their employees. These agreements are known as voluntary, Federal-State and Section 218 Agreements.*

5. Which employees are covered under Social Security and Medicare?

IRS
SSA

Full-time, part-time, temporary, and seasonal employees who are not participating in a qualified public retirement system made available through their employer must be covered by Social Security and Medicare. It is possible for employees under a public retirement systems to also be covered under Social Security because they are covered under a Section 218 Agreement. All employees hired after March 31, 1986, are covered under Medicare.

NOTES

Under existing law, elected officials are considered employees as defined in IRC *section 3401. The regulations do not change this treatment of appointed and elected officials. Although appointed and elected officials are considered employees, the special rules that govern part-time, seasonal and temporary workers do not apply.*

6. What is FICA?

IRS

Federal Insurance Contribution Act (Chapter 21 of the Internal Revenue Code). FICA includes Old-Age, Survivors and Disability Insurance (OASDI or Social Security) and Hospital Insurance (HI or Medicare) taxes.

7. Are there any services which are excluded from FICA and public retirement system coverage?

IRS
SSA

Yes, the following services are excluded unless covered by a Section 218 Agreement:

- *full-time students enrolled and regularly attending classes at the school they are working,*
- *employees hired temporarily to handle disaster emergencies (fire, flood, storm, snow, earthquake or similar emergencies),*
- *election officials and election workers paid less than the threshold amount mandated by law in a calendar year,*
- *persons hired to be relieved from unemployment,*
- *individuals paid for services performed in a hospital, home or other institution where they are a patient or inmate*
- *non-resident aliens with F-1, J-1, M-1 or Q-1 visas.*

8. 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?

STATE

Significant changes in the laws have altered the status of entities and their Social Security and Medicare responsibilities. If an employee is not covered under a Section 218 Agreement or covered by a public retirement system and is not mandatorily excluded from FICA taxes under Federal law, FICA taxes must be withheld, reported and paid. In addition, any employees hired after March 31, 1986, even if covered under the public retirement system, are subject to the Medicare portion of the FICA. The laws have changed so dramatically that if an entity and its employees were exempt from FICA responsibilities 5 or 10 years ago, it may no longer be exempt. Requirements not only vary from one entity to another but on an employee-by-employee basis within the entity. Contact your State Social Security Administrator to determine whether or not you are in compliance with Federal and State laws. *(See page 7-5.)*

9. I have a question regarding Social Security and Medicare coverage requirements, but I'm not sure who to contact.

STATE

The State Social Security Administrator (see page 7-5) should always be an entity's first contact on any questions regarding coverage under Social Security or Medicare.

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10. Where should questions on tax liability which begin, "Do we have to pay Social Security taxes on...?" be directed?

IRS

All questions related to tax liability should be directed to the IRS.

11. Where should questions related to Social Security benefits and earnings records be directed?

SSA

All questions related to Social Security benefits and correct earnings statements should be directed to SSA.

12. What are the consequences of misclassifying a worker?

IRS

For the employer, misclassifying a worker as an independent contractor can result in back taxes, penalties and interest. This error has cost some States and their political subdivisions millions of dollars. (For more information in this area, contact the IRS.)

13. What if the status of the worker cannot be determined?

IRS

Where a question exists as to the employment status of a worker, the State or local entity or the worker may request a determination from the IRS. All pertinent facts relating to the individual's work arrangement should be obtained and submitted to IRS on a Form SS-8 (Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding). When a Form SS-8 is submitted to IRS, all the facts are analyzed and the determination of the worker's status is presented to the employee and employer.

14. I do the payroll for six individuals employed by my village. The other day I had a question concerning whether to withhold Social Security taxes. I called the nearest Social Security office but was told to contact the IRS. Why should I call the IRS since I am asking about Social Security taxes?

IRS

First, contact your State Social Security Administrator to determine if the services are covered for FICA. The IRS is responsible for collecting FICA taxes, including Social Security and Medicare taxes. Therefore, contact IRS regarding when to withhold FICA taxes and where and how to pay them.

15. If IRS is responsible for information on when to withhold FICA taxes and how to pay them, why do we get reporting information from SSA and have to send SSA the Forms W-2?

SSA

People apply to SSA for monthly retirement, disability or survivors benefits. The amount of benefits paid are based in part on an individual's earnings over her/his working career. Therefore, SSA must know about those earnings. The earnings information placed 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 IRS. Either IRS or SSA can help you with reporting questions.

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16. 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?

STATE

Prior to July 2, 1991, the only way a local government (city, village, county, etc.) could cover its employees under Social Security was for the State to include it under the State's Section 218 Agreement with SSA. The agreement extended Social Security coverage to government employers at the State's request. Social Security coverage obtained in this manner cannot be terminated.

First, check with your State Social Security Administrator to determine whether your city is covered by a Section 218 Agreement. If you do not have a Section 218 Agreement, it may be possible to stop paying mandatory Social Security if you create a qualified public retirement system. However, employees hired after March 31, 1986 are mandatorily covered for Medicare.

17. 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 can't be stopped. Why can the other town stop its coverage?

SSA

Beginning July 2, 1991, most State and local government employees are mandatorily covered under Social Security unless they are (1) already covered for Social Security under a Section 218 Agreement or (2) are covered under a public retirement system. For these employees covered mandatorily, coverage ceases if the employer creates a public retirement system for them or places them under an existing public retirement system. The retirement system has to meet the criteria set forth in the Federal Employment Tax regulations.

18. How does an employee verify what Social Security Administration shows on her/his earnings record?

SSA

An employee should request a Form SSA-7004 (Request for Earnings and Benefit Estimate Statement). This form can be obtained from any Social Security office or by calling 1-800-772-1213. There is no charge for this service.

19. What should an employee do if the earnings information on the Personal Earnings and Benefit Estimate Statement (PEBES) is incorrect?

SSA

If the employee has a question or disagrees with the information shown, the employee should contact SSA at 1-800-772-1213.

20. If board members are paid nominal amounts, for example under $1,000 per year, must FICA be withheld?

IRS

Elected and appointed officials are generally considered employees of the public entity they serve. You should withhold FICA taxes unless the official is a member of a public retirement system that is not covered under a Section 218 Agreement. However, any official elected or appointed to their position after March 31, 1986 is subject to Medicare-only withholding.

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21. My employees are paying into the State Teachers' Retirement System and some have enough Social Security credits from a former job, will they receive full benefits from both?

SSA

The Windfall Elimination Provision may result in reduced Social Security benefits. Additionally, spouses' benefits may be reduced by the Government Pension Offset (GPO) formula.

If a person will receive a noncovered pension from a public retirement system such as a State Teachers' Retirement System pension, and the person has enough Social Security credits to be eligible for retirement or disability benefits, a special formula may be used to determine the benefit amounts (producing lower Social Security benefits). The special formula affects workers who reach age 62 or became disabled after 1985 and became eligible after 1985 for a monthly pension based in whole or in part on work not covered by Social Security. A person is considered eligible to receive a pension if the requirements of the pension are met, even if the person continues to work.

22. The union for our employees wants us to begin withholding Medicare Hospital Insurance (HI) for all employees regardless of hire date. They are asking us to bargain on this. Can we make an agreement with them and begin withholding Medicare for everyone?

STATE

If the employees have been in continuous employment with the employer since March 31, 1986, a Section 2l8 Agreement for Medicare HI-only coverage must be executed BEFORE you begin withholding Medicare. Bargaining with the union doesn't change this requirement.

If there is no HI-only Section 2l8 Agreement in effect, SSA will remove the credits from the employees' earnings records even though they have paid taxes. Then the tax paid will have been paid in error. Contact your State Social Security Administrator to prepare an HI-only Section 218 Agreement modification.

23. I was told that we have to withhold Medicare regardless of Social Security coverage or noncoverage. Is this true?

SSA

Yes, for employees hired after March 31, 1986.

24. How do I get a refund if I paid FICA in error?

IRS

An employer may report an adjustment or file a claim for both the employee and employer share of the over reported FICA. An adjustment may be reported on Form 941 (Employer's Quarterly Federal Tax Return) interest free or a claim can be filed using Form 843 (Claim for Refund and Request for Abatement). An employer must file Form 941c (Supporting Statement to Correct Information) or an equivalent supporting statement with either form (941/843). Also, note that the employer will need to prepare and provide Forms W-2c (Statement of Corrected Income and Tax Amounts) and W-3c (Transmittal of Corrected Income and Tax Statements) where appropriate (see the instructions for these forms).

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Determining Worker Status

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NOTES

Introduction

The determination of whether an individual is classified as an independent contractor or an employee for Federal tax purposes has important tax consequences, the most significant of which is the employer's responsibility for employment taxes. Generally, the employer must withhold and pay income taxes, Social Security and Medicare taxes and pay unemployment taxes on wages paid to an employee. Conversely, the employer does not have to withhold or pay taxes on payments made to an independent contractor.

With the exception of statutory employees, the common law standard is used to determine whether the worker is an independent contractor or employee. The standard essentially asks whether the business has the right to "direct and control" the worker. The courts have traditionally looked to a variety of evidentiary facts in applying this standard, and the Internal Revenue Service has adopted those facts to assist in classifying workers.

The following information identifies, clarifies and simplifies the relevant facts that should be evaluated in order to determine accurately worker classification under the common law, under the relevant statutory provisions, and under the relief provision of section 530 of the Revenue Act of 1978.

DETERMINING WORKER STATUS

Who Are Employees?

Before you can know how to treat payments you make for services, you must first know the relationship that exists between you and the person performing the services. The person performing the services may be a:

- section 218 employee
- section 530 worker
- independent contractor
- common law employee
- statutory (non-218) employee
- statutory non-employee.

Initially, evaluate whether the activity/position providing the services to be delivered has been covered under a Section 218 Agreement/modification.

Workers Covered Under Section 218 Agreements

IRC section 3121(d)(4) provides that workers for State and local governments (government entities) are employees for Federal Insurance Contributions Act (FICA) purposes if the government has entered into an agreement with the Social Security Administration to provide FICA coverage pursuant to section 218 of the Social Security Act. These agreements may be broad or may deal with very specific worker groups. Since April 20, 1983, coverage under a Section 218 Agreement cannot be terminated.

NOTES

Public Officers

Generally, public officers are employees for FICA purposes. If there is any question whether a person is a public officer, obtain a copy of, or a reference to, the pertinent statute or ordinance relating to the establishment of the position.

The following normally are public officers:

1. tax collectors and assessors,
2. justices of the peace, and
3. members of boards/commissions.

Jurors are generally not public officers, nor are they employees under the common law. Additionally, notaries public are not public officers.

If an elected official is not covered under a Section 218 Agreement (the position may be excluded) the official is subject to the rules described below.

Important Reminders: As a result of legislative changes since 1986, workers for government entities can also be employees for FICA purposes if they are employees under the common-law rules, even though the worker's services are not covered under a Section 218 Agreement.

- For services performed after July 1, 1991, both OASDI and the Medicare components of FICA apply to State and local government employees, unless the employee is covered by a public retirement system.
- The Medicare portion of FICA taxes applies to wages of State and local government employees hired after March 31, 1986, unless the employee meets the continuing employment exception of IRC section 3121(u)(2)(C).

If the services to be provided are not covered under section 218, the service recipient must determine if section 530 of the Revenue Act of 1978 is applicable. If it is, the employer is relieved of federal employment tax obligations.

It is important to note that there is limited applicability of Section 530 to State and local workers covered under a Section 218 Agreement (IRC Section 3121(d)(4)).

SECTION 530

Section 530 provides government entities with relief from federal employment tax obligations if certain requirements are met. It terminates the government entity's, not the worker's, employment tax liability under Internal Revenue Code (IRC) Subtitle C (Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes (not applicable to State or local government employers), federal income tax withholding, and Railroad Retirement Tax Act taxes) and any penalties attributable to the liability for employment taxes (Revenue Procedure 85-18, 1985-1 C.B. 518).

Section 530(e)(3) of the Revenue Act of 1978, as amended by the Small Business Job Protection Act of 1996, clarifies that the first step in any situation involving whether the government entity has the employment tax obligations with respect to workers is determining whether the government entity meets the requirements of section 530. If so, the government entity will not have an employment tax liability with respect to the worker at issue.

NOTES

The government entity must meet the following consistency and reasonable basis requirements before the relief provisions of section 530 apply:

A) Consistency Test

The government entity must meet both aspects of the consistency test by:

1. filing all required Forms 1099 (reporting consistency), and
2. treating all workers in similar positions the same (substantive consistency).

B) Reasonable Basis Test

The government entity must satisfy one of the following:

1. prior audit safe haven
2. judicial precedent safe haven
3. industry practice safe haven
4. other reasonable basis

Meeting the consistency and reasonable basis tests will give the government entity relief from employment taxes with respect to the workers whose status is in question.

Historical Background

Section 530 of the Revenue Act of 1978, as amended, is not part of the IRC. However, some publishers include its text after IRC section 3401(a). It was originally intended as an "interim" relief measure, but was extended indefinitely by the Tax Equity and Fiscal Responsibility Act of 1982.

Section 530 was amended by section 1706 of the Tax Reform Act of 1986 (1986-3 C.B. (Vol. 1) 698). Section 530(d) denies relief for certain technically skilled workers who provide services under a three party situation.

Section 530(e) was added by section 1122 of the Small Business Job Protection Act of 1996. Section 530(e), which is generally effective after December 31, 1996, contains a number of provisions that affect conditions under which a government entity will be eligible for section 530 relief. These will be addressed in turn.

IRS Must Consider Section 530

It is not necessary for the government entity to claim section 530 relief 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.

Section 530 Limits Guidance

Under section 530, the IRS is barred from issuing any regulations or revenue rulings pertaining to worker classification. As a result, the IRS cannot issue new revenue rulings or even modify existing revenue rulings to reflect new developments. Section 530 imposes no prohibition on private letter rulings or technical advice memoranda. Also, there is no prohibition on publishing guidance dealing with section 530 itself.

NOTES

Section 530 Considered First

The IRS will consider section 530 (relief provision) as the first step in any case involving worker classification. A government entity will also want to consider this aspect. Additionally, the government entity need not concede or agree to the determination that the workers are employees in order for section 530 relief to be available.

Other Tax Consequences For Workers

A government entity may be entitled to relief under section 530 but workers may find, through a determination letter or by some other means, that they have been misclassified and are employees. However, section 530 relief does not extend to the worker. It does not convert a worker from the status of employee to the status of independent contractor. Misclassified employees are liable for the employee share of FICA rather than for tax under the Self Employment Tax Contributions Act (SECA).

SECTION 530 TESTS

A) Consistency Tests

1. Reporting Consistency

Filing Information Returns

The first requirement a government entity must meet to obtain relief under section 530 is timely filing of all required Forms 1099 with respect to the worker for the period, on a basis consistent with the government entity's treatment of the worker as not being an employee. This provision applies only "for the period." Revenue Procedure 85-18, section 3.03(B). That is, if a government entity in a subsequent year files all required returns on a basis consistent with the treatment of the worker as not being an employee, then the government entity may qualify for section 530 relief for the subsequent period. If a government entity is not "required to file," relief will not be denied on the basis that the return was not filed.

Revenue Ruling 81-224, 1981-2 C.B. 197, addresses specific questions about timely filing of Forms 1099. It provides that:

- taxpayers that do not file timely Forms 1099 consistent with their treatment of the worker as an independent contractor, may not obtain relief under the provisions of section 530 for that worker in that year
- taxpayers that mistakenly, in good faith, file the wrong type of Form 1099 do not lose section 530 eligibility.

2. Substantive Consistency

Substantially similar position

A substantially similar position exists if the job functions, duties, and responsibilities are substantially similar and the control and supervision of those duties and responsibilities are substantially similar. In addition, section 530(e)(6), added by the Small Business Job Protection Act, states that the determination of whether workers hold substantially similar positions requires consideration of the relationship between the taxpayers and those individuals. This includes, but is not limited to, the degree of supervision and control. It is also apparent that the contractual relationship and the provision of employee benefits are also to be considered.

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The determination of what is substantially similar work rests on analysis of the facts. The day-to-day services that the worker will perform and the method by which they will be performed are relevant in determining whether workers should be treated as employees or independent contractors. Comparison of job functions is important. Workers with significantly different, though overlapping, job functions are not substantially similar.

Defining Treatment

Revenue Procedure 85-18 provides examples of treatment consistent, or inconsistent, with payments to an independent contractor.

1. The withholding of federal income tax or FICA 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 a Form 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.

> **Note***: Beginning in 1995, household employers report wages paid to household employees on their individual income tax returns using Schedule H rather than Form 942 (obsolete).*

In some cases, government entities pursuant to IRC section 3504 have assumed responsibility for reporting and paying FICA and FUTA taxes and any withheld income taxes with respect to individuals furnished by health and welfare agencies to provide household services for recipients of public assistance (see Notice 95-18, 1995-1 C.B. 300 and Revenue Procedure 80-4, 1980-1 C.B. 581). These government entities will file a Form 941 to report the FICA amounts.

3. The filing of a delinquent or amended employment tax return for a particular tax period is not treatment of the worker as an employee if the filing was a result of IRS compliance procedures. However, filing the 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 use of an IRC section 6020(b) return prepared by the IRS nor the signing of Form 2504 (Agreement To Assessment and Collection of Additional Tax and Acceptance of Overassessment) constitutes treatment.

Treatment for State Purposes

Only federal tax treatment as an employee is relevant to section 530 issue. 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 years it treated them as independent contractors, provided it meets both consistency requirements (reporting and substantive) and reasonable basis for the years prior to the change in treatment. See Revenue Procedure 85-18, section 3.04. The Small Business Job Protection Act added this rule as section 530(e)(5).

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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.

B) Reasonable Basis Tests

1. Judicial Precedent Safe Haven
2. Prior Audit Safe Haven
3. Industry Practice Safe Haven
4. Other Reasonable Basis

Judicial Precedent Safe Haven Test

This safe haven is established by reasonable reliance on judicial precedent or published rulings. It may also be established for a particular government entity by reasonable reliance on a technical advice memorandum, private letter ruling, or a determination letter issued to that entity.

The term "published rulings" refers to revenue rulings which are intended for general use by all employers. Neither rulings by state administrative agencies, including agencies which regulate employment, nor rulings from federal agencies other than the IRS can be used to support a judicial precedent safe haven.

Prior Audit Safe Haven

This safe haven may be established by reasonable reliance on a prior IRS audit of the government entity for employment tax purposes. A taxpayer may not rely on an audit commenced after December 31, 1996 (Small Business Job Protection Act of 1996) for purposes of this safe haven unless the prior 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.

In other words, section 530(e)(2)(A) which was created by the Small Business Job Protection Act now limits the prior audit safe haven to audits that include an examination for employment tax purposes of the status of the class of workers at issue or of a substantially similar class of workers.

An employer may continue to rely on any audit that began before January 1, 1997, even though the audit was not related to employment tax.

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 a Service Center will not constitute an audit.

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

For examinations that began before January 1, 1997, the government entity can establish a prima facie case that a prior audit was conducted by furnishing a copy of correspondence connected with the audit.

Industry Practice Safe Haven

A safe haven may be established based on reasonable reliance on a long-standing recognized practice of a significant segment of the industry in which the government entity is engaged. The practice need not be uniform throughout the entire industry.

The safe haven most commonly argued, and the one which causes the most controversy, is industry practice.

Whether a practice is long-standing depends on the facts and circumstances. However, as confirmed by section 530(c)(2)(C), a practice that has existed for 10 years or more should always be considered as long-standing. Furthermore, a shorter period may be long-standing, depending on the facts and circumstances.

Additionally, section 530(e)(2)(B) provides that 25 percent of the taxpayer's industry is deemed to constitute a significant segment of the industry. The legislative history notes that a lower percentage may be a significant segment, depending on the facts and circumstances.

Other Reasonable Basis

A government entity which fails to meet any of the three safe havens may nevertheless be entitled to relief if it can demonstrate in some other manner any reasonable basis for not treating the worker as an employee.

Reliance on the advice of an attorney or accountant may constitute a reasonable basis. The government entity need not independently investigate the credentials of the attorney or accountant. However, the government entity should establish at a minimum that it reasonably believed the attorney or accountant to be familiar with the issues.

Prior state administrative action (e.g., workers compensation decisions) and other federal determinations (e.g., determinations under the Fair Labor Standards Act) may or may not constitute a reasonable basis. This will depend on whether they use the same common law rules that apply for federal employment tax purposes.

While a number of types of evidence may support a showing of other reasonable basis, more than a mere good faith belief is required. Good faith, although not a sufficient basis for section 530 relief, may be a basis for the IRS not assessing penalties.

Lack of worker social security numbers is not a reasonable basis for not treating workers as employees. Nor is a demand by a worker not to have amounts withheld from wages.

WORKERS COVERED BY SECTION 530

If a government entity meets the requirements of section 530 with respect to a group of workers, it is generally not necessary to determine whether the workers are independent contractors or employees. However it is important to understand the categories of workers to which section 530 applies, and the category to which it does not.

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- **Common Law Employees (IRC section 3121(d)(2)).** Any worker who is an employee under the common law standard would be an employee for purposes of section 530 relief.

WORKERS NOT COVERED BY SECTION 530

- Section 1706 of the Tax Reform Act of 1986 (1986-3, Vol. 1, C.B. 698) (TRA '86), amended section 530 of the Revenue Act of 1978 by adding subsection (d) to that section. Section 530(d) provides that relief under section 530(a) is not available in the case of a worker who, pursuant to an arrangement between the business (or government entity) and a client, provides services for that client as any of the following:

  - engineer
  - designer
  - drafter
  - computer programmer
  - systems analyst
  - other similarly skilled worker engaged in a similar line of work

EFFECT OF SECTION 530 RELIEF ON AN EMPLOYEE

Section 530 relief does not convert a worker from the status of employee to the status of independent contractor. If it has been determined that the worker is an employee, the worker remains an employee for income tax purposes, such as deductions for business expenses and participation in retirement plans.

If the government entity's liability is terminated by section 530(a)(1), the worker remains liable for employee FICA tax with respect to all wages received. See Revenue Procedure 85-18, section 3.08; Treasury Regulations Section 31.3102(c) and Revenue Ruling 86-111, 1986-2 C.B. 176. The worker remains fully liable for the unwithheld employee FICA tax after the government entity's liability has been determined under section 3509. The employee's share of FICA tax is reported on Form 4137 by substituting the word "wages" for "tips."

If the services to be provided by the worker are not identified under a covered position per a Section 218 Agreement/Modification, and section 530 relief is not applicable, determine if the worker falls under any of the categories described in IRC section 3121(d).

- Refer to IRS Publication 1976 (Independent Contractor or Employee?) on page 3-24 for additional information on Section 530 relief.

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COMMON LAW EMPLOYEES

Common Law Standard

The common law is developed mainly by court decisions. Since different courts view facts and circumstances differently, the common law on worker classification is constantly evolving. Thus, our approach to identifying the relevant facts and circumstances that determine a particular worker's status must keep up with the evolution.

The basic standard for determining whether a worker is an employee is whether the service recipient (the government entity) has the right to direct and control the worker as to the manner and means of the worker's job performance. That is, whether the government entity has the right to tell the worker not only as to what shall be done but as to how it shall be done.

The common law test also applies for purposes of the FUTA, federal income tax withholding, and the Railroad Retirement Tax Act.

Control Test

To determine whether the control test is satisfied in a particular case, the facts and circumstances must be examined. The relationship between the worker and the government entity has to be ascertained to determine the degree of control.

Over the years, the IRS and SSA compiled a list of 20 factors used in court decisions to determine worker status. These 20 factors were eventually published in Revenue Ruling 87-41 and are sometimes called the Twenty Factor Test. The Twenty Factor Test is only an analytical tool and not the legal test used for determining worker status. The legal test is whether there is a right to direct and control the means and details of the work.

The 20 common law factors listed in Revenue Ruling 87-41 are not the only ones that may be important. Every piece of information that helps determine the extent to which the instrumentality retains the right to control the worker is important. In addition, the relative importance and weight of the 20 common law factors can vary significantly.

Control Facts Change Over Time

Information that is important in helping determine worker status may change over time because relationships and functionalities change over time. As a result, some of the 20 common law factors listed in Revenue Ruling 87-41 are no longer as relevant as they once were.

INDEPENDENT CONTRACTOR VERSUS EMPLOYEE

The courts have considered many facts in deciding whether a worker is an independent contractor or an employee. These facts fall into three main categories.

- Behavioral Control
- Financial Control
- Relationship of the Parties

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Behavorial Control

Included under this category are facts that show whether the government entity has a right to direct and control how the worker performs the specific task for which he or she is engaged. This includes evaluation of the following issues.

Instructions

Instructions the government entity gives the worker must be evaluated. An employee is generally subject to the government entity's instructions about when, where, and how to work. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved.

Virtually ever government entity will impose on workers, whether independent contractors or employees, some form of instruction (for example, requiring that the job be performed within specified time frames). This fact alone is not sufficient evidence to determine the worker's status.

As with every relevant fact, the goal is to determine whether the government entity has retained the right to control the details of a worker's performance or instead has given up its right to control these details. Accordingly, the weight of "instructions" in any case depends on the degree to which instructions apply to how the job gets done rather than to the end result.

Instructions about how to do the work may cover a wide range of topics, for example:

- when to do the work
- where to do the work
- what tools or equipment to use
- what workers to hire to assist with the work
- where to purchase supplies or services
- what work must be performed by a specified individual (including ability to hire assistants)
- what routines or patterns must be used.
- what order or sequence to follow.

The requirement that a worker obtain prior approval before taking certain actions is an example of instructions.

Degree of Instruction

The degree of instruction depends on the scope of instructions, the extent to which the government entity retains the right to control the worker's compliance with the instructions, and the effect on the worker in the event of noncompliance. All these provide useful clues for identifying whether the government entity keeps control over the manner and means of work performance (leaning toward employee status), or only over a particular product or service (leaning toward independent contractor status).

The more detailed the instructions are that the worker is required to follow, the more control the government entity exercises over the worker, and the more likely the government entity retains the right to control the methods by which the worker performs the work. Absence of detail in instructions reflects less control.

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Presence of Instructions or Mandated Rules

Although the presence and extent of instructions is important in reaching a conclusion as to whether a government entity retains the right to direct and control the methods by which a worker performs a job, it is also important to consider the weight to be given those instructions if they are imposed by the government entity only in compliance with governmental or governing body regulations. If a government entity requires its workers to comply with rules established by a third party (for example, municipal building codes related to construction), the fact that such rules are imposed by the business should be given little weight in determining the worker's status. However, if the government entity develops more stringent guidelines for a worker in addition to those imposed by a third party, more weight should be given to these instructions in determining whether the government entity has retained the right to control the worker.

Suggestions v. Instructions

A suggestion does not constitute the right to direct and control. If compliance with the suggestions are mandatory, then the suggestions are, in fact, instructions.

Unique Identification

In the past, a requirement that a worker wear a uniform or put a business logo on a vehicle had typically been viewed as consistent with employee status.

If the nature of the worker's occupation is such that the worker must be identified with the government entity for security purposes, wearing a uniform or placing the government entity's name on a vehicle is a neutral fact in analyzing whether an employment relationship exists.

Nature of Occupation

The nature of the worker's occupation also 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, training and/or instruction on how to perform their services. In fact, it may be impossible for the government entity to instruct the worker on how to perform the services because it may lack the essential knowledge and skills to do so.

Generally, such professional workers who are engaged in the pursuit of an independent trade, business, or profession in which they offer their services to the public are independent contractors and not employees. See, Treas. Reg. Section 31.3121(d)-1(c)(2). Nevertheless, an employer-employee relationship can exist between a government entity and workers in these occupations. See, James v. Commissioner, 25 T.C. 1296 (1956).

In analyzing the status of professional workers, evidence of control or autonomy with respect to the financial details of how the task is performed tends to be especially important, as does evidence concerning the relationship of the parties.

Nature of Work For Instructions

The absence of need to control should not be confused with the absence of right to control. The right to control contemplated by Treas. Reg. Section 31.3121(d)-1(c)(2) and the common law as an incident of employment requires only such supervision as the nature of the work requires. The key fact to consider is whether the business retains the right to direct and control the worker, regardless of whether the business actually exercises that right.

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Evaluation Systems

Like instructions, evaluation systems are used by virtually all government entities to monitor the quality of work performed by workers, whether independent contractors or employees. Thus, in analyzing whether a government entity's evaluation system provides evidence of the right to control work performance or the absence of such a right, you should consider how the evaluation system may influence the worker's behavior in performing the details of the job.

If an evaluation system measures compliance with performance standards concerning the details of how the work is to be performed, the system and its enforcement are evidence of control over the worker's behavior. However, the lack of a formal evaluation system is a neutral factor.

Training

Training the government entity gives the worker must also be evaluated. An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

Detailed Methods and Procedures

Training is a classic means of explaining detailed methods and procedures to be used in performing a task. Periodic or on-going training provided by a government entity about procedures to be followed and methods to be used indicates that the business wants the services performed in a particular manner. This type of training is strong evidence of an employer-employee relationship.

However, not all training rises to a level signifying an employer-employee relationship. The following types of training, which might be provided to either independent contractors or employees, should be disregarded:

- orientation or information sessions about a government entity's policies, or applicable statutes or government regulations, and
- programs that are voluntary and are attended by a worker without compensation.

Financial Control

This category includes facts which illustrate whether there is a right to direct or control how the business aspects of the worker's activities are conducted. It also includes facts pertaining to whether there is a significant investment, unreimbursed expenses, services available to the market, and opportunity for profit/loss. The method of payment must also be considered.

- Evaluate the extent to which the worker has unreimbursed business expenses. Independent contractors are more likely to have unreimbursed expenses than employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with services they perform for the government entity.
- Evaluate the extent of the worker's investment. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not required for independent contractor status.

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- Evaluate the extent to which the worker makes services available to the market. An independent contractor is generally free to seek out business opportunities. As a result, independent contractors often advertise, maintain a visible business location, and are available to work elsewhere. Of course, these activities are not essential for independent contractor status. An independent contractor with special skills may be contacted by word of mouth without need for advertising.
- Evaluate how the government entity will pay the worker. An employee is generally paid by the hour, week, or month. An independent contractor is usually paid by the job. However, in some professions, such as law, it is not unusual to pay an independent contractor hourly.
- Look at the extent to which the worker can realize a profit or loss. The ability to realize a profit or loss is probably the strongest evidence that a worker controls the aspects of services rendered.

Relationship of the Parties

Courts often look at the intent of the parties. This is most often embodied in a contract. Thus, a written agreement describing the worker as an independent contractor is viewed as evidence of the parties' intent that a worker is an independent contractor.

A contractual designation, in and of itself, is not sufficient evidence for determining worker status. The facts and circumstances under which a worker performs services are determinative of workers' status. Treasury Regulation section 31.3121(d)-1(a)(3) provides that the designation or description of the parties is immaterial. The substance of the relationship, not the label, governs the worker status. The contract may, however, be relevant in ascertaining methods of compensation, expenses that will be incurred, and the rights and obligations of each party with respect to how work is to be performed.

In addition, if it is difficult, if not impossible, to decide whether a worker is an independent contractor or an employee, the intent of the parties, as reflected in the contractual designation, is an effective way to resolve the issue. The contractual designation, is very significant in close cases. See, Illinois Tri-Seal Prods., Inc.V. United States, 353 F.2d 216, 218 (CT. Cl. 1965).

The following items may reflect the intent of the parties:

- **Forms W-2**

  Filing a Form W-2 usually indicated the parties' belief that the worker is an employee. However, workers have succeeded in obtaining independent contractor status even when Forms W-2 were filed (Butts v Commissioner, T.C. Memo 1993-478, aff'd per curiam, 49 F.3d 713 (11th Cir. 1995).

- **Corporation**

  A worker may provide services to a government entity through his or her own closely held or professional corporation. Provided that corporate formalities are properly followed and at least one non-tax business purpose exists, the corporate form is generally recognized for both state law and federal law, including federal tax purposes. Thus, the worker will usually not be treated as an employee of the government entity but as an employee of the corporation.

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- **Employee Benefits**

  Providing the worker with employee benefits traditionally associated with employee status has been an important fact in several recent court decisions. See Weber v. Commissioner, 103 T.C. 378 (1994), aff'd 30 F. 3d (4th Cir. 1995); Lewis v. Commissioner, T.C. Memo 1993-635.

  If a worker receives employee benefits, such as paid vacation days, paid sick days, health insurance, life or disability insurance, or a pension, this constitutes some evidence of employee status. The evidence is strongest if the worker is provided with employee benefits under a tax-qualified retirement plan, IRC section 403(b) annuity, or cafeteria plan, because by statute these employee benefits can only be provided to employees. Some decisions, however, have ascribed less weight to the fact that employee benefits were provided (Butts v. Commissioner, T.C. Memo 1993-478, aff'd per curiam, 49F. 3d 713 (11th Cir. 1995)).

- **Other Governmental Characterizations**

  State laws, or determinations of state or federal agencies, may characterize a worker as an employee for purposes of various benefits. For the purpose of determining worker classification with respect to federal employment tax liability and withholding requirements, characterizations based on these laws or determinations 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 particular policy objectives.

- **Discharge or Termination**

  The circumstances under which a business or a worker can terminate their relationship have traditionally been considered useful evidence bearing on the status the parties intended the worker to have. Some recent court decisions continue to explore such evidence. However, in order to determine whether the facts are relevant to the worker's status, the impact of modern business practices and legal standards governing worker termination need to be considered.

  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 details of how work was performed and, therefore, tended to indicate employee status. Conversely, 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 the parties' intent that the business not have the right to control how the work was performed.

  In practice, however, the government entity rarely has complete flexibility in discharging an employee. The reasons for which a government entity can terminate an employee may be limited; by law, by contract, or by its own practices. As a result, 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 terminated work and payment could be refused or the worker could be sued for nonperformance, this tended to indicate an independent contractor relationship.

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In practice, however, independent contractors may enter into 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 presence or absence of limits on a worker's ability to terminate the relationship, by themselves, 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 significance of facts bearing on the right to discharge/terminate is so often unclear and depends primarily on contract and labor law, these facts should be viewed with great caution.

- **Permanency**

  Courts have considered the existence of a permanent relationship between the worker and service recipient as relevant evidence in 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 their intent to create an employment relationship.

  A long-term relationship may exist between a government entity and either an independent contractor or an employee. It may exist because the contract may be a long-term contract or contracts may be renewed regularly due to superior service, competitive costs, or lack of alternative service providers.

Weighing the Facts and Determining Worker Status under the Common Law

In exploring the relevant facts, it is probable that some 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.

STATUTORY EMPLOYEES, STATUTORY NON-EMPLOYEES, AND OTHER CLASSES OF WORKERS

Statutory Employee

If a worker is not an employee under the usual common law rules, the worker and the government entity may nevertheless still be subject to employment taxes. IRC section 3121(d)(3) lists workers in four occupational groups who, under certain circumstances, are considered employees for FICA tax, but not federal income tax withholding. The groups include: agent-drivers or commission-drivers, full-time life insurance salespersons, traveling or city salespersons, and home workers.

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Workers in these occupations are employees for FICA tax purposes. By definition, a worker can not be a statutory employee under IRC section 3121(d)(3) if that worker is a common law employee. See Lickiss v. Commissioner, T.C. Memo 1994-103.

In order for IRC section 3121(d)(3) to apply when a worker performs services for remuneration for a service recipient, there are three general requirements:

1. The contract of service contemplates that the worker will personally perform substantially all the work.

2. The worker has no substantial investment in facilities other than transportation facilities used in performing the work.

3. There is a continuing work relationship with the business for which the services are performed.

You generally do not need to be concerned with the statutory employee categories. There is one exception: Home workers may be hired by government entities.

Home Workers

Traditionally, this group would have included, but was not limited to, workers who would make such things as clothing, bedding, needlecraft products, or similar products. In addition, it can include workers who provide typing or transcribing services. The work is done away from the government entity's workplace, usually in the worker's own home, the home of another, or a home workshop.

To qualify as a statutory employee, the home worker must meet, in addition to the three general requirements previously mentioned, the following:

- the work must be done in accordance with the specifications given by the government entity (generally simple and consisting of such things as patterns or samples);
- the material or goods on which the work is done must be furnished by the government entity;
- the finished product must be returned to the government entity or to another designation. It is immaterial whether the government entity picks up the work or the worker delivers it.

$100 Rule For Home Workers

IRC section 3121(a)(10) provides that the pay which the home worker receives for such work is not subject to FICA tax unless $100 or more of cash is received during any calendar year.

Statutory Employees' Expenses

A worker can only be a statutory employee if he or she is an independent contractor under the common law. Thus, statutory employees under IRC section 3121(d)(3) are not employees for the purpose of deducting trade or business expenses and may deduct their expenses on Schedule C rather than on Schedule A as miscellaneous itemized deductions. Revenue Ruling 90-93, 1990-2 C.B. 33.

Statutory employees receive a Form W-2. A check is made in Box 15 to indicate that the worker is a statutory employee. Federal income tax withholding does not apply to statutory employees.

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If statutory employees also have earnings from self-employment, they may not use expenses from services as a statutory employee to reduce net earnings from self-employment for purposes of the SECA, IRC section 1402(a). This is because services as a statutory employee do not constitute the carrying on of a trade or business for purposes of SECA. Statutory employees are required to file a Schedule C for services performed as a statutory employee separate from a Schedule C that reports net earnings from self-employment.

Statutory Employees' Benefit Plans

Except for full-time life insurance salespersons, statutory employees under IRC section 3121(d)(3) remain independent contractors for employee benefit purposes. Thus, they are not eligible to participate in the employee benefit plans sponsored by the government entity for employees and cannot enjoy the exclusions from income for amounts paid under accident and health insurance arrangements under IRC sections 104, 105, and 106 to the extent that those income tax exclusions apply only to employees. However, statutory employees can establish and maintain their own self-employed retirement plans.

Statutory Non-Employees

By statute, workers in three occupations are not treated as employees for any purpose under the Internal Revenue Code, provided they meet specific qualifications. The three classes of workers commonly referred to as statutory non-employees are as follows:

1. Real estate agents (IRC section 3508)
2. Direct sellers (IRC section 3508)
3. Companion sitters (IRC section 3506)

Companion Sitters

IRC section 3506 provides that, for purposes of subtitle C relating to employment tax, (FICA and FUTA taxes, and federal income tax withholding), qualifying companion sitters are statutory non-employees.

IRC section 3506 provides that a companion sitter will not be an employee of a companion sitting placement service if the companion sitting placement service neither pays nor receives the salary or wages of the sitter. The placement service may be compensated on a fee basis by either the sitter or the person or business for which the sitting is performed. The companion sitter is deemed to be self-employed unless considered to be a statutory or common law employee of the person or business for which the services are performed. Treasury Regulation sections 31.3506-1(c) and (d).

IDENTITY OF THE EMPLOYER

In certain cases it is clear that the work in question was performed by an employee, but it may not be clear which of two or more entities, organizations or individuals is the employer.

An employer is required to provide an employee with a Form W-2 (IRC section 6051). 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 the employee (IRC section 3401). There is an exception, for tax purposes, that if the person for whom

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the individual performs or performed the services does not have control of the payment of the wages, the term employer means the person having control of the payment of the wages (refer to regulations 31.3401(d)-1(f)).

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 (expressly or implied) which authorizes the employment of the individual, and the individual is hired under this authority, the individual is an employee of the State or of the political subdivision to which the provision applies. If there is no statutory authority (expressed or implied), the identity of the employer must be determined under the common law control test. Note, however, that for the purpose of determining whether an employee's services are covered for Social Security under a Section 218 Agreement, the employer is always the person for whom the individual performs services as an employee.

INDEPENDENT CONTRACTOR

If the worker meets none of the criteria previously described and you've determined that the worker is an independent contractor. Federal income tax or FICA taxes are not withheld from payments. Independent contractors are usually subject to the Social Security and Medicare taxes imposed under the Self Employment Contributions Act (SECA). If at least $600 during the year is paid to an independent contractor, a Form 1099-MISC must be filed. The 1099-MISC identifies:

1. the type of payment,

2. the amount,

3. who made the payment,

4. who received the payment and,

5. backup withholding, if any.

File Form 1099-MISC with the IRS by February 28th. Send all Forms 1099 with Form 1096. The Forms 1099 are used to verify that the independent contractor reported the payment correctly on her/his income tax return. Send a copy of the Form 1099-MISC to each independent contractor by January 31, of the following year. Generally, filing a Form 1099-MISC for payments made to corporations is not required unless the corporation is engaged in providing medical or health care services.

In order to complete Form 1099-MISC, the Taxpayer Identification Number (TIN) of each independent contractor is needed. The independent contractor should complete a Form W-9 when services are contracted.

In some circumstances withholding 31 percent income tax from certain payments may be required. This is called back up withholding. It is required if:

1. a payee does not provide the payer with a taxpayer with a TIN,
2. IRS tells the payer that the TIN is incorrect,
3. IRS notifies the payer that backup withholding is required.

There is a line which is used to report backup withholding on Form 945. Refer to the instructions on Form 945 as needed.

FORM SS-8

NOTES

Occasionally a State or local entity will be unable to determine whether a worker is an employee or whether the worker is self-employed and should be treated as an independent contractor. Many individuals who have personal service contracts with State or local entities may be employees rather than independent contractors. The existence of a contract does not mean that the individual performing the service is not an employee. It is important to the worker that the employment status be determined as soon as possible so that the earnings can be properly reported. Consider the common law factors. If no clear resolution is possible, consider filing a Form SS-8 (Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding) with the IRS for a determination. A Form SS-8 is used to gather information to determine whether a worker is an employee for Federal employment taxes.

All pertinent facts relating to the individual's work arrangement should be obtained and submitted to the IRS on a Form SS-8. A Form SS-8 may be submitted by the State or local entity or the worker. If a contract has been executed between the worker and the entity, a copy of the contract should be furnished with the Form SS-8. When a Form SS-8 is submitted to the IRS, all the facts are analyzed and the determination of a worker's status is presented to the employer in the form of a Determination on Letter Ruling. Direct Forms SS-8 to the local district director of the IRS (Revenue Procedure 97-1).

Several problems arise for a worker when incorrectly treated as an independent contractor. To begin with, the worker would probably pay more taxes (i.e., SECA taxes) than if the worker was being correctly treated as an employee. As an employee, only the employee's portion of the Social Security and Medicare taxes are withheld and paid from the employees wages. As an independent contractor the worker is not eligible for any unemployment benefits or other benefit plans that the worker would have as an employee. Also, as an independent contractor, the worker may also have to pay estimated tax payments each quarter. A worker who is being incorrectly treated as an independent contractor often does not realize this responsibility and the potential for tax problems is created in the form of penalties and interest for underpayment of taxes.

INTEREST AND PENALTIES

Interest

Interest is assessed on any taxes due and unpaid. The interest is in addition to any penalties that may be imposed. Specific provisions allow an employer who has made an under collection or underpayment of the correct amount of FICA taxes or income tax withholding to make an interest free correction (IRC section 6205(a)(1)). The following two provisions 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. Interest-free treatment is also available for adjustments made on delinquent and substitutes for returns (IRC section 3509).

NOTES

Penalties

Employment Tax Penalties. The following penalties describe only 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.

IRC:	The penalty is assessed for:
Section 6651(a)(1)	failure to file a tax return (failure to timely file);
Section 6651(a)(2)	failure to pay tax shown on the return (failure to timely pay) (The penalty is imposed if the amount of tax shown on the return is not paid on or before the prescribed date.);
Section 6651(c)	situations where both the failure to timely file and failure to timely pay apply;
Section 6652	failure to file certain information returns and registration statements, etc. (assessed when there is a failure to file certain information returns not covered under other sections);
Section 6656	failure to make deposit of taxes (when there is failure by any person to deposit in a government depository) on the date prescribed any amount of taxes which is imposed;
Section 6662	underpayment of employment taxes due to disregard of the rules and regulations (accuracy related).

Information Reporting Penalties. The following penalties describe only the most commonly assessed penalties as they relate to information reporting:

Section 6721	failure to file correct information returns on or before the required filing date or where there is failure to include all information required to be shown on the return (or where there is incorrect information shown);
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;
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).

Penalty Rates

1. **Section 6651(a)(1).** The penalty is 5 percent of the tax due per month up to 25percent.
2. **Section 6651(a)(2).** The penalty is .5 percent (one half of one percent) of the tax due per month up to 25 percent.
3. **Section 6651(c).** When both penalties apply for any month, the failure to file penalty is assessed at 4.5 percent.
4. **Section 6652.** Imposes a penalty for tip income unreported to the employer; the penalty is 50 percent of the tax on the unreported tip income.
5. **Section 6656**. 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.
   - 1-5 days late = 2 percent
   - 6-15 days late = 5 percent
   - More than 15 days, but paid by the 10th day after notice and demand (notice and demand date is the assessment date (23C date) = 10 percent.
   - Taxes still unpaid after the 10th day following notice and demand = 15 percent.
6. **Section 6662**. The penalty is 20 percent of the underpayment attributable to negligence or disregard of rules and regulations.
7. **Section 6721.** The penalty for failure to file information reports without all required and correct information (including missing, incorrect and/or unissued TINs) in the required manner is $50 for each failure to a maximum of $250,000 per calendar year.
8. **Section 6722.** 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.
9. **Section 6723.** 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.

NOTES

DEPARTMENT OF THE TREASURY • INTERNAL REVENUE SERVICE

INDEPENDENT CONTRACTOR OR EMPLOYEE?

SECTION 530 PROVIDES BUSINESSES WITH RELIEF FROM FEDERAL EMPLOYMENT TAX OBLIGATIONS IF CERTAIN REQUIREMENTS ARE MET.

Department of the Treasury
Internal Revenue Service
Publication 1976 (9-96)
Catalog Number 22927M

SECTION 530 RELIEF REQUIREMENTS

Your business has been selected for an employment tax examination to determine whether you correctly treated certain workers as independent contractors. However, you will not owe employment taxes for these workers, if you meet the **relief requirements** described below. If you do not meet these **relief requirements**, the IRS will need to determine whether the workers are independent contractors or employees and whether you owe employment taxes for those workers.

Section 530 Relief Requirements: To receive relief, you must meet all three of the following requirements:

I. Reasonable Basis

First, you had a reasonable basis for not treating the workers as employees. To establish that you had a reasonable basis for not treating the workers as employees, you can show that:

- You reasonably relied on a court case about Federal taxes or a ruling issued to you by the IRS; or
- Your business was audited by the IRS at a time when you treated similar workers as independent contractors and the IRS did not reclassify those workers as employees; or
- You treated the workers as independent contractors because you knew that was how a significant segment of your industry treated similar workers; or
- You relied on some other reasonable basis. For example, you relied on the advice of a business lawyer or accountant who knew the facts about your business.

If you did not have a reasonable basis for treating the workers as independent contractors, you do not meet the **relief requirements**.

II. Substantive Consistency

In addition, you (and any predecessor business) must have treated the workers, and any similar workers, as independent contractors. If you treated similar workers as employees, this relief provision is not available.

III. Reporting Consistency

Finally, you must have filed Form 1099-MISC for each worker, unless the worker earned less than $600. Relief is not available for any year you did not file the required Forms 1099-MISC. If you filed the required Forms 1099-MISC for some workers, but not for others, relief is not available for the workers for whom you did not file Forms 1099-MISC.

The IRS examiner will answer any questions you may have about your eligibility for this relief.

4

Social Security Coverage

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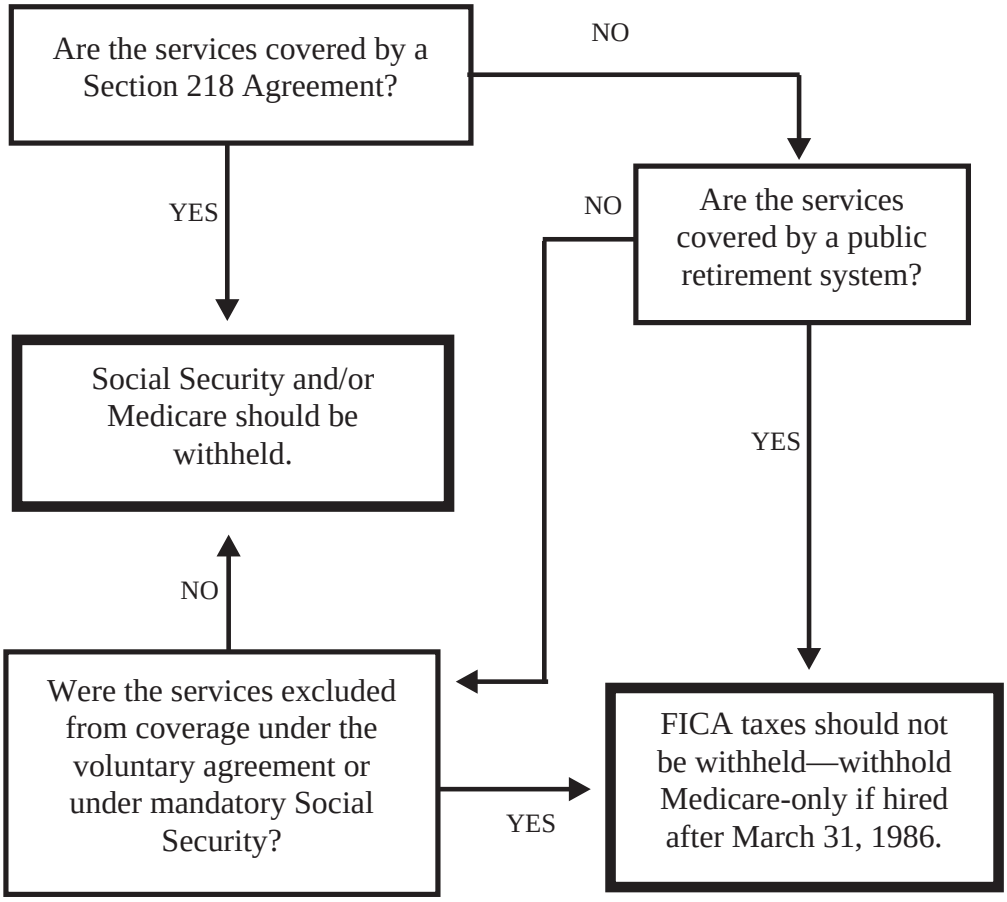
Social Security Coverage



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Social Security Exclusions Checklist

The following services checked yes, cannot be covered by Section 218 Agreements and are excluded from mandatory Social Security coverage:

	✓ Yes	✓ No
Was the employee hired to be relieved from unemployment?		
Is the employee an inmate or patient hired to perform service in a hospital, home or other institution?		
Is the employee hired to perform services on a temporary basis in case of fire, storm, snow, earthquake, flood or similar emergency?		
Is the employee hired to provide covered transportation services which are covered under Section 210(k) of the *Social Security Act*? (Excluded under coverage of Section 218 only.)		
Is the employee hired to perform services (other than agricultural labor or service performed by a student) not defined as "employment" under other provisions of section 210(a) of the *Social Security Act?*		
Is the service performed by an election official or election worker (1) who is paid less than the threshold amount mandated by law in a calendar year, and (2) who is not covered by a Section 218 Agreement? This applies to Section 218 coverage only if the State has executed a modification.		
Is the individual treated as self-employed and compensated for services solely on a fee basis? (Excluded from coverage unless the State specifically includes them under a Section 218 Agreement.)		

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Note

The information in this chapter is about Social Security coverage for State and local government employees and how it is obtained. Contact your State Social Security Administrator with any questions.

General Coverage Rules

Social Security and/or Medicare coverage for employees of State and local governments can be determined three different ways:

1. States may extend Social Security and/or Medicare coverage to employees of the State and its political subdivisions through voluntary agreements with the SSA. The agreements are commonly referred to as "Section 218 Agreements."
2. Effective for services performed after July 1, 1991, full Social Security coverage is mandatory, with certain exceptions, for all State and local government employees who are not covered under a Section 218 Agreement or by a public retirement system.
3. State and local government employees who are not covered for Social Security under a Section 218 Agreement or by mandatory law, and who were hired or rehired after March 31, 1986, are subject to mandatory Medicare-only coverage, unless specifically excluded by law.

*Note: The term "**full Social Security**" includes both the Old-Age, Survivors and Disability Insurance (OASDI) program and Medicare Hospital Insurance (HI).*

History

State and Local Social Security

Prior to 1951, Social Security was not available to employees of states and their political subdivisions, i.e., "governmental/State entities," even on a voluntary basis. There was a Constitutional question regarding the power of the Federal government to tax State and local governments. In January 1951, as a result of legislation enacted by Congress, it became possible to provide Social Security coverage to employees of a State or State political subdivision by means of an agreement between the Federal government and the State as described in Section 218 of the *Social Security Act.* At first, only the services of employees whose positions were not covered by a public retirement system could be covered under a Section 218 Agreement.

As a result of further legislation, beginning in 1955, services of employees in public retirement system positions could be covered. Under retirement system coverage, the employees had the option to decide, through an election (referendum), whether or not they wanted to be covered by Social Security. If at that time they voted to be covered by Social Security, they could be brought under coverage by means of a Section 218 Agreement. From that time on, any services performed by an employee of such an entity, not otherwise excluded, would be covered for Social Security (and Medicare once it became available). The State was responsible for paying Social Security contributions which were the equivalent of the employer's and employee's share of FICA taxes.

Chronology

1935 *Social Security Act* passed providing for Federal old-age insurance, Federal State public assistance and unemployment compensation, and extension of public health services, maternal and child health services, services for crippled children, child welfare services, and vocational rehabilitation services; three member Social Security Board created to administer the Act.

1939 Federal Security Agency created with Social Security Board within it.

1946 Social Security Board abolished and functions transferred to the Federal Security Administrator who created the SSA with a Commissioner of Social Security to run it.

1949 Bureau of Employment Security which administered unemployment insurance transferred from SSA to Labor Department.

1950 Social Security Amendments of 1950 allowed States to cover, on a voluntary basis, employees not under a retirement system by means of a Section 218 Agreement beginning in 1951.

1953 Federal Security Agency abolished; SSA transferred to Department of Health, Education, and Welfare. Commissioner of Social Security to be appointed by the President with the advice and consent of the Senate.

1954 Social Security Amendments of 1954 extended coverage even further by allowing states, on an elective basis, to cover State and local government employees under existing retirement systems. Many groups of employees under existing retirement systems had been adamant against even elective coverage in 1950. However, other groups desired coverage, so the provision in the 1954 Amendment resulted. In fact, in a few instances after the 1950 Amendment was passed, an existing retirement system would be repealed so that coverage could be obtained, followed shortly thereafter with the previous system (or a modification) being reinstituted.

1956 Social Security Amendments of 1956 gave more opportunities for coverage for State and local government employees under existing retirement systems.

1958 & 1960 The 1958 and 1960 Social Security Amendments added only slightly to the coverage of the program by bringing in a small number of individuals in certain categories, principally in State and local government employment. The 1960 Amendments added a small amount of coverage, including employment in American Samoa and Guam.

1965 Medicare was legislated.

1983 States were no longer permitted to terminate Section 218 Agreements (and those that had withdrawn in the past were allowed to opt in again).

1985 Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985 mandated, with certain exceptions, Medicare HI-only coverage for State and local government employees hired or rehired after March 31, 1986.

1986 In 1986, Congress enacted the Omnibus Budget Reconciliation Act (OBRA '86). It had two major effects on the way State entities treat Social Security taxes under the Federal Insurance Contribution Act (FICA). First, OBRA '86 enacted Section 3121(b)(7)(E) of the IRC which provides that services covered under a Section 218 Agreement will be treated as employment for purposes of FICA, effective with respect to wages paid after December 31, 1986. Second, OBRA '86 amended Section 218 of the Social Security Act so that beginning January 1, 1987, State governments were relieved from the collection of Social Security contributions from local government entities, and the liability for verifying and depositing the amounts owed by local governments. Instead, each State and political subdivision became responsible for FICA tax collection and payment to the IRS, in the same manner as private employers.

NOTES

Chronology continued

1990 Legislation in 1990 extended coverage, on a compulsory basis (effective beginning July 2, 1991) to virtually all State and local government employees who are not covered by a retirement system (other than certain mandatorily excluded services) and who are not already covered by an agreement.

1994 On August 15, 1994, *Social Security Independence and Program Improvements Act* of 1994 (effective March 31, 1995) was signed. In addition to establishing SSA as an independent agency, the Act allows the existing optional exclusions from Social Security coverage for election workers to be raised to $1,000; and extends to all states the option of covering police and firefighter positions under a public retirement system.

Agreement Termination

Prior to April 20, 1983, States could terminate Social Security coverage for employees covered under Section 218 Agreements. However, the Social Security Amendments of 1983 amended Section 218 to provide that no agreement can be terminated, in whole or in part, on or after April 20, 1983. This applies to any agreement in effect on April 20, 1983, without regard to whether a notice of termination was in effect on that date, and to any agreement or modification thereof which became effective after that date. Thus, any agreement which had not already terminated prior to April 20, 1983, may not be terminated. This applies not only to voluntary terminations, but also to involuntary terminations for failure to comply with the agreement, including partial terminations in cases where an entity has been legally dissolved. Contact the State Social Security Administrator to determine the entity's status. (See list of State Administrators beginning on page 7-5.)

Payment of Social Security and Medicare Taxes

In 1986, Congress enacted the *Omnibus Budget Reconciliation Act* of 1986 (OBRA '86). It had two major effects on the way State and local entities treat Social Security and Medicare taxes under the *Federal Insurance Contribution Act* (FICA). First, OBRA '86 enacted section 3121(b)(7)(E) of the *IRC*. Section 3121(b)(7)(E) provides that services covered under a Section 218 Agreement will be treated as employment for purposes of FICA, effective with wages paid after December 31, 1986. Second, OBRA '86 amended Section 218 of the Act so beginning January 1, 1987, State governments were relieved from:

1. collecting Social Security contributions from local government entities, and
2. liability for verifying and depositing the amounts owed by local governments.

Each State and local entity is now required to file a Form 941 with the IRS. IRS is responsible for collecting Social Security taxes from public employers and verifying the deposits and amounts owed. (Refer to IRS Publication 15.)

Mandatory Social Security

Prior to July 2, 1991, Social Security coverage was voluntary, i.e., State and local government employers (through action by the State) could voluntarily cover their employees.

Under the *Omnibus Budget Reconciliation Act* of 1990, Congress amended the IRC and the Act so that wages paid to State and local government employees who are not members

NOTES

of a public retirement system are generally subject to FICA taxes for service performed after July 1, 1991. Employees currently covered under the Medicare portion of FICA remain subject to that tax regardless of their membership in a retirement system. Employees covered by Social Security under a Section 218 Agreement were already having FICA withheld and, therefore, not affected by this legislation.

Section 218 Agreements

State and local government employees can be covered by Social Security and Medicare through an agreement between the State and SSA to:

1. Provide full Social Security coverage for nonretirement system coverage groups and retirement system groups.
2. Provide coverage for services performed by employees which are excluded from mandatory coverage provisions, but are only optional exclusions under Section 218 Agreements, e.g., student services; services of election officials and election workers who earn less than the threshold amount mandated by law in a calendar year;
3. Cover services for Medicare-only for employees hired prior to April 1, 1986, who are members of a public retirement system.

Each State's original agreement incorporates the basic provisions, definitions, and conditions for coverage under the agreement. Additional coverage is provided by **modifications** to the original agreement. Each modification, like the original agreement, is binding upon all parties. **The initiative for securing coverage is 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 the Federal and State laws.

By agreement, the State contracts to obtain Social Security protection (retirement, survivors, disability, and hospital insurance) for the employees it covered under the agreement. State and local government employees, after being covered under an agreement, have the same benefit rights and responsibilities as any other employee who has Social Security coverage. The cost of providing Social Security protection for State and local government employees is the same as 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 amount of coverage.

Coverage Groups

Once an agreement is entered into with a State, employees of the State and its political subdivisions are brought under the agreement in groups known as "coverage groups." There are two basic types of coverage groups:

1. Groups composed of employees of the State or one of its political subdivisions whose positions are **not** under a State or local retirement system (absolute coverage groups); and
2. Retirement system coverage groups, which are groups composed of employees whose positions **are covered** by a State or local retirement system.

NOTES

The *Social Security Act* (Act) gives each State the right to decide which coverage groups to include under its Section 218 Agreement.

Absolute Coverage Groups Absolute coverage groups as defined by section 218(b)(5) of the Act are as follows:

- employees of the State engaged in performing services in connection with the governmental (nonproprietary) functions,
- employees of a State engaged in performing services in connection with a single proprietary function,
- certain civilian employees working with the National Guard of a State,
- individuals employed under an agreement between the United States and the State to perform services as inspectors of agricultural products,
- employees of a political subdivision of a State engaged in performing services in connection with the governmental (nonproprietary) functions,
- employees of a political subdivision of a State engaged in performing services in connection with a single proprietary function, and
- noncertified school district employees of specified states (applicable to actions taken before 1962).

Retirement System Coverage Groups. Groups covered by a public retirement system can also be covered by full Social Security through a Section 218 Agreement. Retirement system coverage groups as defined by Section 218(d)(4) of the Act are as follows:

- the entire system,
- the employees of the State,
- the employees of each political subdivision,
- the employees of the State and the employees of any one or more political subdivisions,
- the employees of any combination of political subdivisions,
- the employees of a hospital which is an integral part of a political subdivision,
- the employees of two or more hospitals, each of which is an integral part of the same political subdivision, and
- the employees of each institution of higher learning.

Divided Retirement System Coverage Groups. The Act authorized certain States and all interstate instrumentalities to divide a retirement system established by the State, a political subdivision thereof, or the 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.

Coverage for Employees under Retirement Systems

Majority Vote 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

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the referendum itself is a State matter, Federal law requires that the following conditions be met:

- eligible employees are given not less than 90 days' notice of the referendum;
- an opportunity to vote is given and limited to eligible employees;
- the referendum be held by secret ballot;
- the referendum was supervised by the Governor (or his/her designee); and
- a majority of the retirement system's eligible employees voted for coverage.

***Note**: The referendum procedures must be conducted under the direction of 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 voting all eligible members and dividing the system into two parts on the basis of the member's choice. The State may also subdivide the retirement system into two parts or systems based on the members choice, and then conduct a majority vote referendum among the employees who chose coverage. The conditions for a referendum are the same as those given for the majority vote referendum with one exception. The voting ballots are not secret since the individuals choosing coverage must be identified.

***Note**: The referendum procedures must be conducted under the direction of the State Social Security Administrator.*

Mandatory Exclusions

Full Social Security coverage (mandatory or voluntary) is NOT possible for the following kinds of work, i.e., mandatory exclusions under the *Social Security Act*, §218(c)(6) and §210(a)(7)(F)

- Services performed by individuals hired to be relieved from unemployment.

  Note: This exclusion does not include services performed by individuals under work-training or work-study programs which 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 employer.

  Note: Usually, services performed by prisoners/inmates in a State or local prison or jail are excluded from coverage whether or not the services are performed outside the confines of the prison or jail, because the prisoners are normally not in an employment relationship with the State or political subdivision.

  Note: Services performed by prisoners/inmates outside the prison/jail for an entity other than the State or local government operating the prison or jail, such as on a work-release program, can be covered if an employment relationship exists.

  Note: Services performed by patients or inmates outside the institution for the same unit of government operating the institution are considered to be services "in the institution."

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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 transportation system employees who are covered compulsorily under Section 210(k) of the Act.
- Services performed for a State or local government by workers hired on a temporary basis in emergencies such as a fire, storm, snow, earthquake, flood or other similar emergency.
- Services performed by election officials/workers who are paid less than $100 in a calendar year before 1995, or less than $1,000 in a calendar year from 1995 through 1999. Effective January 1, 2000, the $1,000 threshold will be indexed each year for inflation.

  Note: The election worker exclusion amount specified in the Section 218 Agreement remains the same unless the agreement is modified to reflect the higher exclusion.

- Services that would be excluded if performed for a private employer, except certain agricultural labor and work by students*. The services most commonly excluded here are those performed by a nonresident alien temporarily residing in the U.S. holding an F1, J1, M1 or Q1 visa, when the services are performed to carry out the purpose for which the alien was admitted to the U.S.

  * See next section, **Optional Exclusions**.

- Services performed in a position compensated solely on a fee basis by an individual who is treated as self-employed. (A State may optionally include the position under a Section 218 Agreement.)

Optional Exclusions

Under Section 218 of the Act, a State could, at its option, exclude from coverage the following services performed by members of any coverage group including retirement system coverage groups. (Although exclusions were originally taken, OBRA '90 required some of the groups to be covered under a public retirement system or full Social Security.)

- 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 for which the pay is on a fee-basis.**
- Agricultural labor, but only those services which would be excluded if performed for a private sector employer.*
- Services performed by a student which would be excluded if performed for a private employer.**
- Services performed by election officials or election workers if the remuneration paid in a calendar year is less than $1,000 (less than $50 per quarter and $100 per year is still possible).**

Note: *These groups, if originally excluded from a State's Section 218 Agreement, must now be covered under a public retirement system or full Social Security.
**These groups, if originally excluded from a State's Section 218 Agreement, continue to be excluded from coverage under OBRA '90 even if they are not under a public retirement system.

NOTES

These exclusions could be taken by the State in any combination it wished for each separate coverage group. Any services which a State chose to exclude could be included later if permitted by State law and the State's agreement. Generally, if one of the types of work listed above has been included for a coverage group, it cannot later be removed from coverage except for the service performed by election officials or election workers if the remuneration paid in a calendar year is less than the threshold amount mandated by law.

State Entities and Reporting Officials

When coverage under a Section 218 Agreement is obtained, the employing entity is responsible for reporting to SSA the amount of wages paid to the employees whose services are covered under the agreement. The entity is also responsible for paying the employment taxes with respect to the wages paid to all such employees. These reporting requirements also apply to wages subject to mandatory Social Security and Medicare. (See IRS Publication 15 for more detailed information.)

The reporting officials should be familiar with Form 941 filing requirements, Federal Tax Deposit requirements, information return requirements, and maintaining appropriate records. The IRS has the responsibility for investigating incorrect reports, failures in reporting, and assisting local officials in the proper preparation of wage and tax reports.

Identity of the Employer for Social Security Coverage and Taxation Purposes

Situations may arise where the employee works for more than one entity and the identity of the employer is not clear. Look to who the employer is in determining whether coverage exists under the State's Section 218 Agreement.

The employer is that entity having the final authority to control the worker in the performance of the work or which reserves the right to do so. Generally, if there is any provision in a statute or ordinance, expressed or implied, which authorizes the employment of the individual, 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, expressed or implied, the identity of the employer must be determined under the common law analysis.

Fees

Generally, a fee for Social Security coverage and taxation purposes exists when a public official receives and retains remuneration for services directly from the public. Conversely, it is not considered to be a fee when a public official receives payment for services from government funds and no portion of the monies collected from the public belongs to or can be retained by the public official as compensation.

A fee is distinguished from a salary when the compensation for a particular service is paid directly to the State or political subdivision public official by the party for whom the service is performed. 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. (Rev. Rul. 74-608, 1974-2 C.B. 275.)

Fee-Basis Exclusion—Position Compensated by Salary and Fees. A State may exclude services from Social Security/Medicare coverage under an agreement in all or any class or classes of fee-basis positions compensated by both salary and fees. If the exclusion is taken, none of the compensation received, including the fees, is covered wages under the State's agreement.

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Positions Compensated Solely by Fees. Services in any class or classes of 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.

Applicability of Federal and State Laws to Coverage Issues

Federal law governs in making determinations involving coverage of State and local government employees. These determinations may be based on decisions regarding specific issues to which the 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. Such interpretations are accepted if they are reasonable.

The chart below shows the more significant issues that will require such determinations and the authority under which the determinations are to be made:

	Issues	Authority
1.	Does an employer-employee relationship exist?	Federal Law
2.	What is the identity of the employer?	Federal Law
3.	Are earnings wages?	Federal Law
4.	What are emergency services?	Federal Law
5.	What are student services?	Federal Law
6.	Who is an officer of a State or political subdivision?	State Law
7.	Is an entity a political subdivision?	State Law
8.	Is a function governmental or proprietary?	State Law
9.	Is a position under a retirement system?	State Law
10.	Which employees are eligible for membership in a retirement system?	State Law
11.	Who is an employee for purposes of retirement system participation?	State Law

NOTES

Issues and questions regarding whether to withhold FICA, should be decided by the IRS; issues regarding whether to report the earnings as wages, should be decided by SSA. However, there are often situations where State laws may have a bearing on the issue. 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 attempting contact with either IRS or SSA, contact the State Social Security Administrator for guidance. (See list of State Administrators beginning on page 7-5.)

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 which, although connected with police and firefighting functions, are not actually police officers and firefighter positions.

Effective for services covered by modifications filed by states after August 15, 1994, all states may cover police officer and firefigher positions under a retirement system. Prior to that date the Act generally prohibited the coverage of police officers and firefighters whose positions were under a retirement system except in the following States (and all interstate instrumentalities):

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	

The majority vote referendum must be used unless the State is allowed to use the divided retirement system referendum. (Interstate instrumentalities may use the divided retirement system procedures.)

If the police officers and firefighters are 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.

Positions Not Under a Retirement System

Generally, police officer and firefighter positions that are not under a retirement system are covered when the agreement is made applicable to the absolute coverage group of which they are a part in the same manner as other employees whose positions are not covered by a retirement system.

Foreign Students, Teachers and Apprentices

Currently any individual's wages earned within the United States are taxed whether or not they are U.S. citizens. 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

The rules for nonresident aliens are complex. For more information on specific issues, contact the IRS or SSA. (See IRS Publications 515, 519 and 901 for additional information.)

Questions

NOTES

1. What are the rules regarding Native Americans who work off and on reservations?

IRS

The coverage rules for Native Americans, on or off the reservation, are generally the same as for anyone else. Several exceptions exist such as tribal council members and income from certain fishing rights.

2. How is prison inmate labor handled?

SSA
IRS

Generally, services performed by prisoners for the State or local political subdivision which operates the prison are excluded from coverage whether or not performed outside the confines of the prison. This is because prisoners usually are not in an employment relationship with the State or political subdivision. Services performed by inmates outside the prisons or an entity other than the State or local governmental unit, e.g., a work-release program, can be covered if an employment relationship exists and the conditions of coverage for that entity are met. Services performed by inmates outside the institution for the same unit of government which operates it are considered performed "in the institution." Also, services performed by inmates as part of the rehabilitative and therapeutic program of the institution are not usually performed as employees.

3. Who should public employers contact regarding coverage issues, the State Social Security Administrator, IRS or the SSA?

STATE
SSA
IRS

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.

4. When is a Section 218 Agreement necessary and/or appropriate?

STATE

- *To provide full Social Security coverage for employees already under a State or local retirement system. This will provide both full Social Security and public retirement system coverage.*
- *To provide full Social Security coverage for absolute coverage groups prior to choosing retirement system coverage.*
- *To provide coverage for services performed by employees which are excluded from mandatory coverage provisions, but are only optional exclusions under Section 218 Agreements, e.g., student services; services of election officials and election workers who earn less than the threshold amount mandated by law in a calendar year;*
- *To increase the threshold amount for services performed by election officials/workers.*
- *To provide Medicare only coverage for employees who are members of a State or local retirement system and were hired before April 1, 1986.*

Modifications to Section 218 Agreements are necessary to include additional coverage groups, cover additional services in a group already covered (e.g., services previously optionally excluded), cover ineligibles, employees changing to the "yes" group in a divided retirement system, cover previously terminated groups, etc.

NOTES

5. A utility district's Section 218 Agreement, effective on January 1, 1959, covers the services of all positions for FICA purposes. The utility district, on July 1, 1994, joins the State's public employees retirement system. Would FICA coverage continue?

IRS

FICA coverage continues for all employees because the addition of a retirement system does not alter the FICA coverage under the Section 218 Agreement.

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 FICA taxes?

IRS

The worker and county must pay FICA 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 or Medicare at that time.

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 FICA coverage. The city provides no retirement plan for its employees. Must the city council member and city pay FICA taxes?

IRS

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 FICA taxes for services performed after July 1, 1991, as a result of the mandatory FICA provisions.

8. Do students have to pay into Social Security during the summer?

SSA
IRS

If the Section 218 Agreement excluded students from coverage, the same requirements apply during the summer as the rest of the school year. Students must be enrolled and regularly attending classes at the school they are working.

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Medicare/Hospital Insurance Coverage

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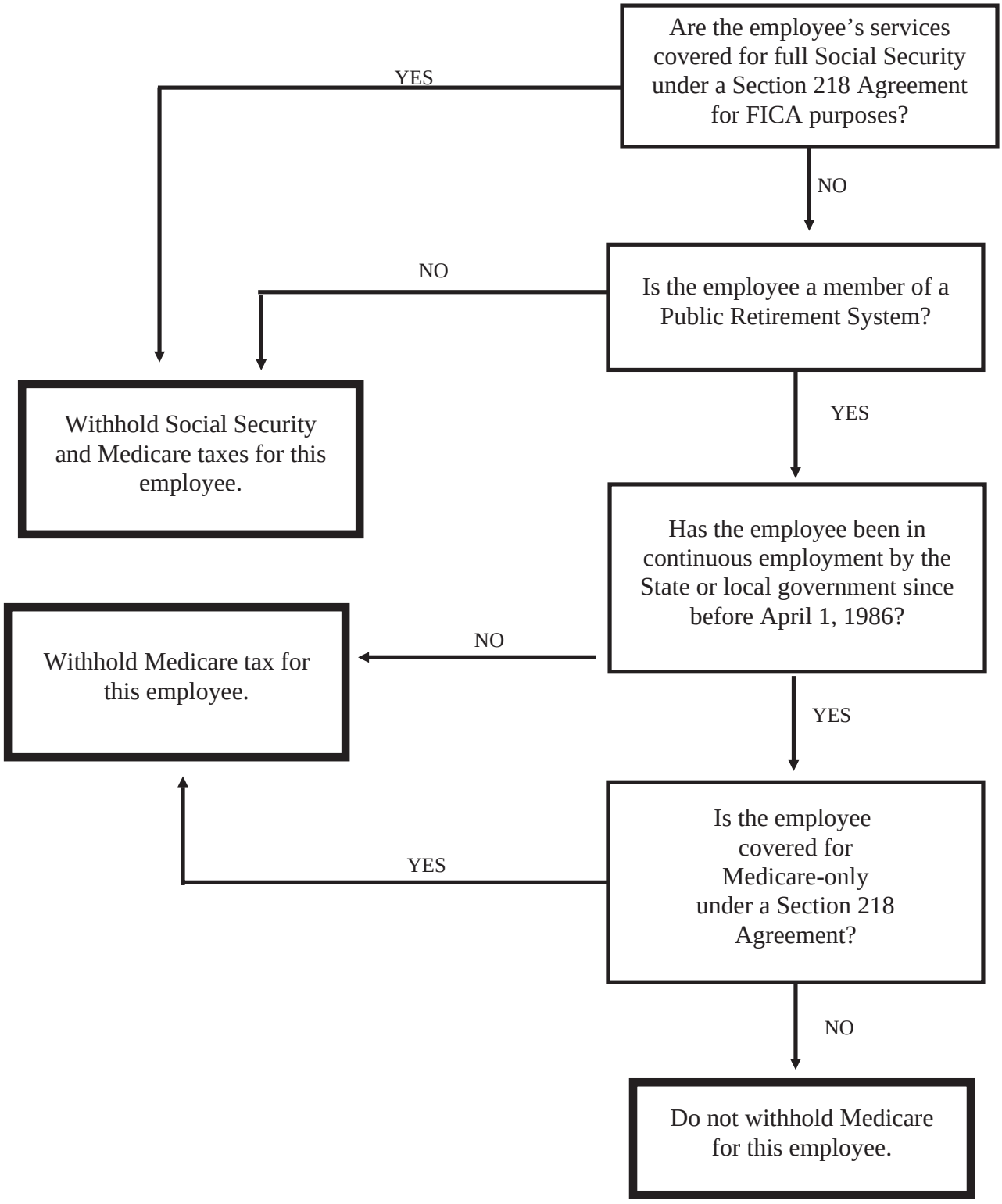
Medicare Coverage



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Medicare Coverage

Medicare is a Federal health insurance program for people age 65 and over, younger people who have been entitled to Social Security disability benefits for 24 months, and persons who need dialysis or kidney transplants for treatment of end-stage kidney disease. As a Medicare beneficiary, one can choose how to receive hospital, doctor, and other health care services covered by Medicare. Beneficiaries can receive care either through the traditional fee-for-service delivery system or through coordinated care plans, such as health maintenance organizations and competitive medical plans, which have contracts with Medicare.

Medicare consists of Hospital Insurance Protection (Part A) and Medical Insurance Protection (Part B). Medicare is administered by the Health Care Financing Administration (HCFA), not SSA. HCFA administers the program and sets the standards that hospitals, skilled nursing facilities and other providers and suppliers of services must meet. SSA provides information about the program and handles enrollment.

Hospital Insurance

Hospital Insurance means that the persons protected may have benefits paid for certain hospital and related health care services when they incur expenses for such services. A person entitled to Social Security monthly benefits or a qualified railroad retirement beneficiary is automatically entitled to hospital insurance protection beginning with the first day of the month age 65 is attained. An individual who is entitled to monthly benefits need not file a separate application to receive hospital insurance.

Medical Insurance

Medical Insurance protection means that the persons protected may have benefits paid for certain physicians' services (including surgery), home health services, clinical laboratory service, durable medical equipment and some other items and services not covered under the hospital insurance protection. Individuals enrolled in Part B pay a monthly premium for the insurance.

Medicare Tax Withholding

As an employer, Social Security and Medicare taxes are levied on both the State or local entity and its employees. The State or local entity must collect and pay the employee's part of the taxes and it must pay a matching amount. Beginning in 1994, no wage base limit exists for Medicare tax.

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 are required to pay the Medicare-only portion of FICA are referred to as "Medicare Qualified Government Employees" (MQGE).

NOTES

Employees who have been performing regular and substantial services since March 3l, 1986, who are not covered for full FICA under a Section 218 Agreement nor subject to the mandatory FICA provisions, remain exempt from both Social Security and Medicare taxes (providing they are members of a public retirement system). A Section 218 Agreement can be modified, however, to provide Medicare-only coverage for employees who are members of a public retirement system and not covered for full FICA under a Section 218 Agreement. Contact your State Social Security Administrator (see page 7-5) for further information.

Services not Subject to Mandatory Medicare Coverage

The Continuing Employment Exception

Services performed after March 31, 1986, by an employee who was hired by the State employer or the political subdivision employer before April 1, 1986, are exempt from mandatory Medicare coverage if the employee meets all of the following requirements:

1. employee was performing regular and substantial services for remuneration for the State employer or political subdivision employer before April 1, 1986;
2. employee was a bona fide employee of that employer on March 31, 1986;
3. employment relationship with that employer was not entered into for purposes of avoiding the Medicare tax; and
4. employment relationship of the employee with that employer has been continuous since March 31, 1986. (See Rev. Rul. 86-88 and Rev. Rul. 88-36 concerning the continuing employment exception, Appendix A-17 and A-23.)

Exclusions

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

1. 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.)
2. 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.
3. Services performed by an employee on a temporary basis in case of fire, storm, snow, earthquakes, flood or other similar emergency.
4. Services performed by an election worker or official whose pay in a calendar year is less than the amount mandated by law.
5. Services excluded from Social Security coverage for reasons other than government employment.

NOTES

Medicare Exclusions Checklist	✓ Yes	✓ No
The following services when checked yes, are not subject to mandatory Medicare-only coverage:		
Is the employee covered under a Section 218 Agreement? (If yes, the employee is covered for full Social Security.)		
Has the employee been in continuous employment since March 31, 1986, **and** Medicare coverage has not been opted into under a modified Section 218 Agreement, **and** the employee has been covered by a public retirement system since July 2, 1991?		
Was the employee hired to be relieved from unemployment?		
Is the employee an inmate or patient hired to perform services in the hospital, home or other institution where they are an inmate or patient?		
Is the employee hired to perform services on a temporary basis in case of fire, storm, snow, earthquake, flood or similar emergency?		
Is the service performed by an election official or election worker who is paid in a calendar year less than the threshold amount?		
Are the services excluded for reasons other than government employment?		

Questions

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?

IRS

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 . (Rev. Rul. 86-88)

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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?**

IRS

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)) (Rev. Rul. 86-88)

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?**

IRS

*No. The employment must **not** have been terminated in order for the continuing employment exception to apply.*

4. **How is termination of employment defined for purposes of determining whether the Medicare tax is applicable?**

IRS

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 if an employment relationship has been terminated. (Rev. Rul. 86-88)

5. **An employee, who was hired before April 1, 1986 by the State, transferred after March 31, 1986, to another entity of the State. The transfer was made without terminating the employee's employment with the State. Does the employee qualify for the continuing employment exception?**

IRS

*Yes. An employee hired before April 1, 1986, by a State entity who transfers after March 31, 1986, to another entity 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 employer of that same 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.

NOTES

6. Are employees hired prior to April 1, 1986, who are not currently paying into Medicare going to be able to enroll in Medicare in the future?

SSA

If an individual's services are not covered under Social Security and Medicare, or Medicare-only, the individual may not become insured (i.e., have enough work credits) for Medicare. That individual could then become entitled to such coverage only by means of sufficient "outside" work which is covered for Social Security or Medicare-only to enable the employee to become insured for such coverage, or become entitled to Medicare on the earnings record of an insured spouse.

Also, State or local public employers can voluntarily choose to cover one or more groups of employees under Medicare, 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.

7. Can employees hired prior to April 1, 1986, who are not currently paying into Medicare pay into Medicare if they want to?

STATE

An employee may not make voluntary Medicare contributions if the employee's services are not covered under Medicare. However, an employer could still provide Medicare coverage for employees who are members of a retirement system under the Section 218 Agreement through the State Social Security Administrator.

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?

IRS

The teacher must pay only the Medicare portion of the FICA because the employee was hired after March 31, 1986.

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 that begins in January 1987 subject to the Medicare tax?

IRS

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.

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?

IRS

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&A6 of Rev.Rul. 86-88.)

6

Public Retirement Systems

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Definition of Retirement System

In general, **for purposes of mandatory Social Security coverage (but not Section 218 coverage)**, a pension, annuity, retirement or similar fund or system is not a retirement system with respect to an employee unless it provides a retirement benefit to the employee that is comparable to the benefit provided under the Old-Age portion of the Old-Age, Survivor and Disability Insurance (OASDI) program of Social Security. Whether a retirement system meets this requirement is usually determined under the safe harbor benefit formulas established by Revenue Procedure 91-40 (see Appendix A-25) and the IRS regulations.

Whether service in the employ of a State or locality is excluded from mandatory Social Security coverage is determined based on membership in the State's or locality's retirement system. A retirement system includes any pension, annuity, retirement, or similar fund or system, that is maintained by a State, political subdivision, or instrumentality thereof to provide retirement benefits to its employees who are participants. Whether a plan is maintained to provide retirement benefits with respect to an employee is determined under the facts and circumstances of each case. For example, a plan providing only retiree health insurance or other deferred welfare benefits is not considered a retirement system. Nor is the Social Security system a retirement system.

➔ *Example: Under an employment arrangement, a portion of an employee's compensation is regularly deferred for five years. Because a plan that defers the receipt of compensation for a short span of time rather than until retirement is not a plan that provides retirement benefits, this arrangement is not a retirement system. 26 C.F.R. §31.3121(b)(7)-2(e)(1).*

➔ *Example: An individual holds two positions with the same political subdivision. The wages earned in one position are subject to FICA tax pursuant to a Section 218 Agreement. Because the Social Security System is not a retirement system, the exception from Social Security coverage does not apply to service in the other position unless the employee is otherwise a member of a retirement system of such political subdivision. 26 C.F.R. §31.3121(b)(7)-2(e)(1).*

Types of Qualifying Retirement Systems

Background

IRS determines what constitutes a retirement system for purposes of mandatory coverage, and what constitutes membership in such a retirement system. In general, IRS addresses two concepts of retirement systems—**the defined benefit system** and the **defined contribution system**. Each of these systems is based on a type of retirement plan—a defined benefit plan or a defined contribution plan.

Retirement systems must provide a minimum benefit. Generally, any retirement system that satisfies the minimum benefit requirement is treated as a retirement system. "Qualified" status is irrelevant. 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 specifications of the minimum benefit requirement are contained in the regulations and in Revenue Procedure 91-40 (See Appendix A-25).

NOTES

Defined Benefit Plan

A defined benefit plan generally is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to the employer's employees over a period of years, usually for life, after retirement. Retirement benefits under a defined benefit plan are measured by and based on various factors such as years of service rendered by the employee, compensation earned by the employee and the age of the employee at retirement.

Defined Benefit Retirement System

A defined benefit retirement system is a pension, annuity, retirement or similar fund maintained by the State or political subdivision that provides a retirement benefit to the employee that is comparable to the benefit provided under the Old-Age portion of the Old-Age, Survivor and Disability Insurance programs of Social Security. This determination can be made by applying the safe harbors in Revenue Procedure 91-40 and the IRS regulations to the retirement system's benefits.

Revenue Procedure 91-40 contains several safe harbor benefit formulas that may be used to determine if a **defined benefit system** meets the minimum benefit requirement. 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 her/his years of service.

Defined Contribution Plan

A **defined contribution plan** is 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 or forfeitures of accounts of other participants that may be allocated to such participant's account.

Defined Contribution Retirement System

A defined contribution retirement system (Section 401(a), 403(b) or 457 plans, for example) is also a State or political subdivision maintained pension, annuity, retirement or similar fund which must receive an allocation to the employee's account of at least 7.5 percent of the employee's compensation for services during the period. Combinations of employer and employee contributions may be used to arrive at the 7.5 percent, however, the 7.5 percent cannot include any earnings on the account. Matching contributions by the employer may be taken into account for this purpose. A plan consisting of employee only contributions (provided they are at least 7.5 percent of compensation) would also satisfy the minimum benefit requirement.

To qualify as a defined contribution retirement system, the employee's account must be credited with a reasonable interest rate or it must be held in a separate trust subject to fiduciary standards and credited with actual earnings. Further, the definition of compensation must generally be no less inclusive than the definition of the employee's base pay.

Definition of Compensation

The definition of compensation used in determining whether a defined contribution retirement system meets the minimum retirement benefit requirement must generally be no less inclusive than the definition of the employee's base pay as designated by the employer or the retirement system, provided such designation is reasonable under all the facts and circumstances. Thus, for example, a defined contribution retirement system will not fail to

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meet this requirement merely because it disregards for a purpose one or more of the following: overtime pay, bonuses, or single-sum amounts received on account of death or separation from service under a bona fide vacation, compensatory time or sick pay plan, or under severance pay plans. Any compensation in excess of 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 has a calendar year plan. In 1995, 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 wage base in October 1995. The employee is a qualified participant in the plan for all of the 1995 plan year without regard to whether the employee ceases to participate at any time after reaching the maximum contribution base. 26 C.F.R. §31.3121(b)(7)-2(e)(2)(iii)(B).*

Reasonable Interest Rate Requirement

A defined contribution retirement system does not satisfy the minimum level of benefits requirement with respect to an employee unless the employee's account is credited with earnings at a rate that is reasonable under all the facts and circumstances, or employees' accounts are held in a separate trust that is subject to general fiduciary standards and are credited with actual earnings on the trust fund. Whether the interest rate with which an employee's account is credited is reasonable is determined after reducing the rate to adjust for the payment of any administrative expenses.

Definition of Qualified Participant

Defined Benefit Retirement Systems

For the purpose of excluding service in the employ of a State or locality from mandatory Social Security coverage, based on membership in the State or locality's retirement system, whether an employee is a qualified participant in a defined benefit retirement system is determined as services are performed. 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 under the retirement system 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, such as 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:*** *Where a State maintains a defined benefit plan that is a retirement system within the meaning of IRS regulations, and under the terms of the plan, employees in positions covered by the plan must complete six months of service before becoming participants, the exception from Social Security coverage does not apply to services of an employee during the employee's six months of service prior to the employee's initial entry into the plan. The same result occurs even if, upon the satisfaction of this service requirement, the employee is given credit under the plan for all service with the employer (i.e., if service is credited for the six-month waiting period). This is true even if the employee makes a required contribution in order to gain the retroactive credit. The same*

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result also occurs if the employee can elect to participate in the plan before the end of the six-month waiting period, but does not elect to do so. 26 C.F.R. §31.3121(b)(7)-2(d)(1)(i).

➔ **Example:** *Where a political subdivision maintains a defined benefit plan that is a retirement system within the meaning of IRS regulations, and 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. 26 C.F.R. §31.3121(b)(7)-2(d)(1)(i).*

Defined Contribution Retirement Systems

For the purpose of excluding service in the employ of a State or locality from Social Security coverage, based on membership in the State or locality's retirement system, whether an employee is a qualified participant in a defined contribution retirement system is determined as services are performed. An employee is a qualified participant in a defined contribution or other individual account 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 her/his account (exclusive of earnings) that meets the minimum retirement benefit requirement with respect to compensation during any 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 Title 26, Subtitle C, Chapter 21, Section 3121(b)(7)(F).

➔ ***Example:*** *Where a State-owned hospital maintains a nonelective defined contribution plan that is a retirement system within the meaning of IRS regulations, and 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, employees may not be treated as qualified participants in the plan before the last day of the year. However, assuming the same facts, except that, 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 the employee would have received at the end of the year, e.g., based on compensation earned since the beginning of the plan year, if the pro rata allocation available on a given day would meet the minimum retirement benefit requirement with respect to compensation from the beginning of the plan year through that day (or some later day), employees are treated as qualified participants in the plan on the day. 26 C.F.R. §31.3121(b)(7)-2(d)(1)(ii).*

➔ ***Example:*** *A political subdivision maintains an elective defined contribution plan that is a retirement system within the meaning of IRS regulations. The plan has a calendar year plan year and 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 with respect to compensation during that time, and it is not certain at that time 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*

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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. 26 C.F.R. §31.3121(b)(7)-2(d)(1)(ii).

Part-Time, Seasonal And Temporary Employees

Special rules apply to part-time, seasonal and temporary employees for purposes of determining if these employees are considered qualified participants in a public retirement system. Part-time, seasonal and temporary employees, whose services are not covered by a Section 218 Agreement but who are qualified participants of a public retirement system, are exempt from mandatory Social Security coverage. In general, the benefits of these employees under the public employer's retirement system must be fully vested (i.e., may not be forfeitable). The special vesting requirement is considered to be met if the part-time, seasonal or temporary employee has the right to receive, by reason of separating from employment, a payment of at least 7.5 percent of compensation earned (plus interest) while covered under the retirement system.

Note: *Under a special transition rule, in general, beginning after July 1, 1991, and ending on the last day of the plan year in 1992, the 7.5 percent amount is reduced to six percent. These requirements should not be confused with coverage groups under Section 218 Agreements.*

Part-Time Employee

A part-time employee 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 a part-time employee if the teacher normally has classroom hours of one-half or more of the number of classroom hours designated by the educational institution as constituting full-time employment, provided that such designation is reasonable under all the facts and circumstances. 26 C.F.R. §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. 26 C.F.R. §31.3121(b)(7)-2(d)(2)(iii).*

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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. 26 C.F.R. §31.3121(b)(7)-2(d)(2)(iii).

Temporary Employee

A temporary employee is any employee performing services under a contractual arrangement with the employer of two years or less duration that is not likely to be extended, e.g., a teacher under an annual contract who has a history of contract extensions is not a temporary employee. Possible contract extensions may be considered in determining the duration of a contractual arrangement, only if, under the facts and circumstances, there is a significant likelihood that the employee's contract will be extended. Future contract extensions are considered likely to occur for purposes of this rule if, on average, 80 percent of similarly situated employees (i.e., those in the same or a similar job classification with expiring employment contracts) have had bona fide offers to renew their contracts in the immediately preceding two academic or calendar years. In addition, future contract extensions are considered significantly likely to occur if the employee has a history of contract extensions with respect to her/his current position. An employee is not considered a temporary employee for purposes of this rule solely because the employee is included in a unit of employees covered by a collective bargaining agreement of two years or less duration. 26 C.F.R. §31.3121(b)(7)-2(d)(2)(iii)(C).

Determining Benefits

Whether an employee is a part-time, seasonal or temporary employee with respect to allocations or benefits under a retirement system is generally determined based on service in the position in which the allocations or benefits were earned, and does not take into account service in other positions with the same or different States, political subdivisions or instrumentalities thereof. All of an employee's service in other positions with the same or different States, political subdivisions or instrumentalities thereof 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 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 and that both of these political subdivisions contribute to the same State-wide 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 under the retirement system, then the employee is not considered a part-time employee of either the county or the municipality for purposes of the nonforfeitable benefit requirement of IRS regulations. 26 C.F.R. §31.3121(b)(7)-2(d)(2)(iii)(D).*

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Individuals Employed In More Than One Position

If an employee is a member of a retirement system with respect to service the employee performs in one position in the employ of a State, or a political subdivision or instrumentality of a State, the employee is generally treated as a member of a retirement system with respect to all service performed for the same State, political subdivision, or instrumentality in any other position. A State is a separate entity from its political subdivisions, and an instrumentality is a separate entity from the State or political subdivision by which it is owned for purposes of this rule. 26 C.F.R. §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 such 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, and neither the service nor the compensation in the part-time position is considered in determining the employee's retirement benefit under the county retirement plan. Nevertheless, if the retirement plan meets the requirements of IRS regulations with respect to the individual, the exclusion from employment under section 3121(b)(7) applies to both the employee's full-time and part-time service with the county.*

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 one position, the employee is generally treated as a member of a retirement system with respect to all service performed for the same State, political subdivision or instrumentality in any other positions. 26 C.F.R. §31.3121(b)(7)-2(c)(2).

➔ *Example: An individual is employed full-time by a State and is a member of its retirement plan. The individual 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. 26 C.F.R. §31.3121(b)(7)-2(c)(2).*

Alternative Lookback Rule

This rule allows the employer to determine an employee's eligibility status to participate in a retirement plan based on past work experience or reasonable expectations as to meeting eligibility requirements during the first year of employment. (26 C.F.R. §31.3121(b)(7)-(2)(d)(3)(ii)) In general, the rules regarding qualified participants apply equally to former participants who continue to perform service for the same State, political subdivision or instrumentality thereof or who return after a break in service. Thus, for example, a former employee of a political subdivision with a deferred benefit under a defined benefit retirement system maintained by the political subdivision who is reemployed by the political subdivision, 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, required to be taken into account). 26 C.F.R. section 31.3121(b)(7)-2(d)(3)(iii).

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Treatment of Re-Hired Annuitants

A person is deemed to be a qualified participant in the retirement system without regard to whether the person continues to accrue a benefit or whether the distribution of benefits under the retirement system has been suspended pending cessation of services if:

- the person is a former participant in a retirement system maintained by a State, political subdivision or instrumentality thereof,
- the person has previously retired from service with the State, political subdivision or instrumentality, and
- the person is either in pay status (i.e., is currently receiving retirement benefits) under the retirement system or has reached normal retirement age under the retirement system.

This rule also applies in the case of an employee who has retired from service with another State, political subdivision or instrumentality thereof that maintains the same retirement system as the current employer, provided the employee is a former participant in the system by reason of the employee's former employment. Thus, for example, if a teacher who retires from service with a school district that participated in a State-wide 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 State-wide system, the employee is treated as a re-hired annuitant. 26 C.F.R. §31.3121(b)(7)-2(d)(4)(ii).

Questions

1. What is a qualified public retirement system?

IRS

A qualified public retirement system is a retirement system maintained by a State, political subdivision or instrumentality thereof that meets the qualification tests under section 3121(b)(7)(F) of the Internal Revenue Code. (See Revenue Procedure 91-40, Appendix A-25.)

2. What does it mean to be a member of a retirement system?

IRS

A member must actually participate in the system. If an employee is eligible to participate and decides not to, that individual will be subject to FICA taxes. One exception is individuals who "drop-out" because they have reached the maximum benefit level and cannot accrue additional benefits.

A special "lookback rule" allows the employer to determine an employee's eligibility status to participate in a retirement plan based on past work experience or reasonable expectations as to meeting eligibility requirements during the first year of employment. For example, a part-time, seasonal or temporary employee may be treated as a member of a retirement system for a calendar year if the employee was a member of the retirement system on the last day of the plan year ending in the previous calendar year.

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3. What is a retirement plan?

IRS

The definition follows the Social Security Act's description found in 42 U.S.C. Sec. 418(b)(4). A retirement plan is "a pension, annuity, retirement, or similar fund or system established by a State or by a political subdivision thereof." The final regulations clearly state that section 457 plans qualify as a "retirement system." In addition, retirement plans (both defined benefit and defined contribution) must meet the tests described below.

Final Salary Averaging Period	Average Compensation Factor
36 months	1.50 percent
37-48 months	1.55 percent
49-60 months	1.60 percent
61-120 months	1.75 percent
Over 120 Months	2.00 percent

4. What are the benefit levels for a safe harbor defined benefit (DB) system?

IRS

The general rule is that the plan must offer a "meaningful" benefit—that is, a benefit comparable to Social Security's primary insurance amount. Safe harbor rules in the Revenue Procedure 91-40 set up minimum DB retirement benefit tests 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. The Revenue Procedure contains a chart. If the system caps the amount of income that can be used to calculate retirement benefits to less than the FICA wage base or base pay, the safe harbor must be adjusted.

5. What are the benefit levels for a safe harbor defined contribution (DC) system?

IRS

To qualify, DC systems are required to allocate at least 7.5 percent of a worker's annual compensation into the employee's account. The contribution may be entirely made by either the employee or employer, or may include a combination of before - or after-tax contributions made by the employer and/or the employee. Benefits can be provided through section 457 plans, section 403(b) tax-sheltered annuities or other DC arrangements.

If the plan existed prior to the passage of OBRA '90 (November 5, 1990), it can satisfy the contribution test with a 6 percent rate instead of 7.5 percent during the transition period through the end of 1992.

6. How are part-time, seasonal and temporary workers defined under the rules for FICA coverage (section 3121(b)(7)(F) of the Internal Revenue Code)?

IRS

A part-time employee works 20 hours or less per week. A seasonal employee works full-time but less than 5 months a year, and 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 may be considered in determining the duration of a contractual arrange-

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ment if there is a significant likelihood that the employee's contract will be extended. 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.

7. 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 arrangement for it to satisfy the rules. The vesting requirement 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 quits, retires or is terminated. The regulations point to an index for long-term Federal debt instruments, the Applicable Federal Rate, as a reasonable interest rate.

Involuntary distributions to an employee when the employee terminates do not violate the vesting requirement, as long as the amount is $3,500 or less.

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

8. 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.

9. Is there any waiting period in which FICA 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, FICA taxes do not have to be paid during this interim period. This rule does not apply to part-time, seasonal and temporary employees.

10. How do the rules apply to volunteer firefighters?

If a volunteer firefighter is paid a nominal amount for each fire responded to and has no other benefits of employment, mandatory coverage does not apply. These individuals fall under the exception for temporary hiring of employees in the event of a disaster. Reimbursements for expenses must be properly accounted for.

11. A city that has not executed a Section 218 Agreement provides retirement coverage with a defined contribution plan to only some of its employees. The employees not covered by the retirement plan pay FICA taxes under the mandatory Social Security provisions. Does a retirement plan that does not cover all employees qualify under IRS regulations 31.3121(b)(7)-2?

A qualified retirement system is one that provides a retirement benefit comparable to the old-age (retirement) benefit portion of the OASDI program of Social Security. Whether a retirement system meets this requirement is generally determined on an individual basis. Thus, a pension plan that is not a retirement system for some employees may be a retirement system with respect to other employees.

7

The Role of the State Social Security Administrator

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What Is a State Social Security Administrator

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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. The notice should be sent to:

> Social Security Administration
> P.O. Box 70
> Baltimore, MD 21203
>
> A copy of the change should also be sent to the Parallel Social Security Office (PSSO). (See list on page 8-5.) The PSSO will notify the SSA regional commissioner. In addition, the district and regional offices of the IRS should be notified.

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

- administer/maintain the Federal-State Agreement (Section 218 Agreement) which governs voluntary Social Security 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, or identify additional political subdivisions which join a covered retirement system;
- provide SSA with notice and evidence of the legal dissolution of covered State or political subdivision entities;
- resolve coverage and taxation questions with SSA and the IRS related to the agreement and modifications;
- 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 Section 218 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. Responsibilities will vary from some States having limited or no interaction and others performing monitoring, quasi-regulatory and enforcement functions with non-Section 218 entities.

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 look to the Administrator to help resolve questions as to who is and is not covered.

State and local government coverage provisions of the Act are complex. 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

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these interrelate to provide Social Security protection to public employees. It is important that there continue to be a central point within each State where this expertise and experience is brought together for these purposes.

National Conference of State Social Security Administrators (NCSSSA)

The ever-changing and complex Social Security and employment tax regulations require constant monitoring and interpretation. For over 45 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/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 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 periodically 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 list on next page.)

Audits and Reviews of Public Employers

When an audit or review of a public employer by IRS or SSA is to be conducted in a State, the State Social Security Administrator may be consulted to clarify the employer's status, including:

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

State Social Security Administrators

Alabama
State Social Security Administrator
P.O. Box 302602
Montgomery, AL 36130
(334) 242-7066 • FAX (334) 242-2440

Alaska
State Social Security Administrator
Division of Retirement & Benefits
P.O. Box 110203
Juneau, AK 99811-0203
(907) 465-4470 • FAX (907) 465-3086

Arizona
State Social Security Administrator
Arizona State Retirement System
3330 North Central
P.O. Box 33910
Phoenix, AZ 85067-3910
(602) 240-2022 • FAX (602) 240-2083

Arkansas
State Social Security Administrator
Public Employees' Retirement System
One Union National Plaza
124 W. Capitol
Little Rock, AR 72201-1015
(501) 682-7800

California
State Social Security Administrator
Public Employees' Retirement System
P.O. Box 942709
Sacramento, CA 94229-2709
(916) 326-3624 • FAX (916) 658-1586

Colorado
State Social Security Administrator
Colorado Dept. of Labor & Employment
Public Employees' Social Security
1515 Arapahoe Street, Tower 2, Suite 700
Denver, CO 80202-2117
(303) 620-4432 • FAX (303) 620-4485

Connecticut
State Social Security Administrator
Office of the State Comptroller
Retirement Division
55 Elm Street
Hartford, CT 06106
(860) 702-3551 • FAX (860) 702-3489

Delaware
State Social Security Administrator
Office of Pensions
Thomas Collins Building
P.O. Box 1401
Dover, DE 19903-1401
(302) 739-4208 • FAX (302) 739-6129

Florida
State Social Security Administrator
Division of Retirement
Cedars Executive Cntr, Building C
2639 N. Monroe Street
Tallahassee, FL 32399-1560
(904) 488-5540 • FAX (904) 488-5290

Georgia
State Social Security Administrator
Employees' Retirement System
Two Northside 75, Suite 300
Atlanta, GA 30318
(404) 352-6414 • FAX (404) 352-6431

Hawaii
State Social Security Administrator
Employees' Retirement System
201 Merchant Street, Suite 1400
Honolulu, HI 96813-2929
(808) 586-1700 • FAX (808) 586-1677

Idaho
State Social Security Administrator
Division of Statewide Payroll
State Auditor's Office
700 West State Street
Boise, ID 83720
(208) 334-2394 • FAX (208) 334-3338

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State Social Security Administrators continued

Illinois
State Social Security Administrator
State Employees' Retirement System
2101 S. Veterans Parkway
P.O. Box 19255
Springfield, IL 62794-9255
(217) 785-2340 • FAX (217) 785-7019

Indiana
State Social Security Administrator
Public Employees' Retirement Fund
Suite 800, Harrison Building
143 West Market Street
Indianapolis, IN 46204
(317) 232-4116 • FAX (317) 232-1614

Iowa
State Social Security Administrator
Public Employees' Retirement System
600 East Court Avenue
P.O. Box 9117
Des Moines, IA 50306-9117
(515) 281-0024 • FAX (515) 281-0053

Kansas
State Social Security Administrator
Department of Administration
Division of Accounts and Reports
Room 355S, Landon State Office Bldg.
900 SW Jackson St.
Topeka, KS 66612
(913) 296-2311 • FAX (913) 296-6841

Kentucky
State Social Security Administrator
State Office for Social Security
P.O. Box 557
Frankfort, KY 40602-0057
(502) 564-3952 • FAX (502) 564-2124

Louisiana
State Social Security Administrator
Department of Treasury
Division of Social Security
P.O. Box 44154
Baton Rouge, LA 70804-4154
(504) 342-0026 • FAX (504) 342-1650

Maine
State Social Security Administrator
Maine State Retirement System
Station #46
Augusta, ME 04333
(207) 287-3455 • FAX (207) 287-3451

Maryland
State Social Security Administrator
Division of Social Security
301 West Preston Street
Baltimore, MD 21201
(410) 767-4806

Massachusetts
State Social Security Administrator
State Board of Retirement
One Ashburton Place, Room 301
Boston, MA 02108
(617) 727-1556 • FAX (617) 727-1175

Michigan
State Social Security Administrator
Office of Retirement Systems
General Office Building - 1A
P.O. Box 30171
Lansing, MI 48909-7671
(517) 322-5704 • FAX (517) 322-6332

Minnesota
State Social Security Administrator
Room 200, Centennial Office Bldg.
658 Cedar St.
St. Paul, MN 55155
(612) 296-7956 • FAX (612) 282-5353

Mississippi
State Social Security Administrator
Public Employees' Retirement System
429 Mississippi Street
Jackson, MS 39201
(601) 359-3589 • FAX (601) 359-2124

State Social Security Administrators continued

Missouri
State Social Security Administrator
Division of Accounting
Office of Administration
P.O. Box 809
Jefferson City, MO 65102-0809
(573) 751-4715 • FAX (573) 751-0523

Montana
State Social Security Administrator
Public Employees' Retirement Division
1712 9th Avenue
Helena, MT 59620
(406) 444-3154 • FAX (406) 444-4328

Nebraska
State Social Security Administrator
Department of Admin. Services
P.O. Box 94664, State Capitol
Lincoln, NE 68509-4664
(402) 471-0621 • FAX (402) 471-4157

Nevada
State Social Security Administrator
Division of Employment Security
500 East Third Street
Carson City, NV 89713
(702) 687-4510 • FAX (702) 687-3903

New Hampshire
State Social Security Administrator
Department of Health & Human Services
6 Hazen Drive
Concord, NH 03301
(603) 271-4204 • FAX (603) 271-2896

New Jersey
State Social Security Administrator
New Jersey Division of Pensions
20 West Front Street - CN295
Trenton, NJ 08625
(609) 292-0132 • FAX (609) 393-4606

New Mexico
State Social Security Administrator
Public Employees' Retirement Assoc.
P.O. Box 2123
Santa Fe, NM 87504-2123
(505) 827-4700 • FAX (505) 827-4670

New York
State Social Security Administrator
N.Y. State Retirement System
15th Floor A E Smith Bldg.
Albany, NY 12244
(518) 474-1101 • FAX (518) 474-2142

North Carolina
State Social Security Administrator
Department of State Treasurer
325 North Salisbury Street
Raleigh, NC 27603-1385
(919) 733-6555 • FAX (919) 715-4334

North Dakota
State Social Security Administrator
Job Service - North Dakota
P.O. Box 5507
Bismarck, ND 58506-5507
(701) 328-2838 • FAX (701) 328-2728

Ohio
State Social Security Administrator
Department of Admin. Services
30 E. Broad Street, 28th Floor
Columbus, OH 43266-0405
(614) 466-2942 • FAX (614) 728-0312

Oklahoma
State Social Security Administrator
State Bureau of Social Security
Department of Human Services
P.O. Box 25352
Oklahoma City, OK 73125-5352
(405) 521-3818 • FAX (405) 521-3181

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State Social Security Administrators continued

Oregon
State Social Security Administrator
Public Employees' Retirement System
200 S. W. Market Street
P.O. Box 23700
Tigard, OR 97281-3700
(503) 603-7735

Pennsylvania
State Social Security Administrator
521 Labor & Industry Bldg.
Harrisburg, PA 17120
(717) 787-2816
FAX (717) 787-9019

Puerto Rico
State Social Security Administrator
Department of the Treasury
Box 9024 140
San Juan, PR 00902-4140
(787) 723-3585 • FAX (787) 723-6215

Rhode Island
State Social Security Administrator
Office of the General Treasurer
40 Fountain Street
Providence, RI 02903
(401) 277-2287 • FAX (401) 277-2212

South Carolina
State Social Security Administrator
South Carolina Retirement Systems
P.O. Box 11960, Capitol Station
Columbia, SC 29211-1960
(803) 737-6933 • FAX (803) 737-6947

South Dakota
State Social Security Administrator
Old Age & Survivors Insurance
Office of the State Auditor, State Capitol
500 E. Capitol Avenue
Pierre, SD 57501
(605) 773-3325 • FAX (605) 773-5929

Tennessee
State Social Security Administrator
Old Age & Survivors Insurance Agency
Consolidated Retirement System
Andrew Jackson State Office Bldg.
10th Floor
Nashville, TN 37243-0237
(615) 741-7902 • FAX (615) 532-8725

Texas
State Social Security Administrator
Social Security Program
Employees' Retirement System of Texas
P.O. Box 13207
Austin, TX 78711-3207
(512) 867-3373 • FAX (512) 867-3334

Utah
State Social Security Administrator
State Social Security Agency
Room 2110 - State Office Bldg.
Salt Lake City, UT 84114
(801) 538-3024 • FAX (801) 538-3244

Vermont
State Social Security Administrator
Social Security Division
Office of the State Treasurer
133 State Street
Montpelier, VT 05633
(802) 828-2305 • FAX (802) 828-5182

Virginia
State Social Security Administrator
Virginia Retirement System
P.O. Box 2500
Richmond, VA 23218-2500
(804) 344-3128
FAX (804) 786-1425

Virgin Islands
State Social Security Administrator
Department of Finance
Government of the Virgin Islands
Charlotte Amalie, VI 00801
(809) 774-4750 Ext. 2261
FAX (809) 776-4028

State Social Security Administrators continued

Washington
State Social Security Administrator
Office of Management Review
Employment Security Department
P.O. Box 9046
Olympia, WA 98507-9046
(360) 438-4856 • FAX (360) 438-3174

Wisconsin
State Social Security Administrator
Department of Employee Trust Funds
P.O. Box 7931
Madison, WI 53707
(608) 266-0728 • FAX (608) 266-5801

West Virginia
State Social Security Administrator
Social Security Section
State Auditor's Office
West Wing 100, State Capitol Bldg.
Charleston, WV 25305
(304) 558-2250 Ext. 210
FAX (304) 558-4155

Wyoming
State Social Security Administrator
Wyoming Retirement System
Social Security Division
1st Floor - East Herschler Bldg.
Cheyenne, WY 82002
(307) 777-6109 • FAX (307) 777-5995

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Questions

1. What is the responsibility of State Social Security Administrators to Section 218 entities?

STATE

The State Social Security Administrator has legal responsibilities to entities covered by a Section 218 Agreement as governed by the Social Security Act. *These responsibilities encompass the duties associated with administering and maintaining the Federal-State Agreement and the modifications to that agreement.*

2. What is the responsibility of State Social Security Administrators to non-Section 218 entities?

STATE

The State Social Security Administrator has no legal responsibility to entities ***not*** *covered by a Section 218 Agreement according to the* Social Security Act; *however some States may have elected responsibilities such as providing notification of law changes or enforcement functions to enhance compliance with applicable laws.*

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 her/his State?

IRS

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 sharing of 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.

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4. What information can be provided by SSA to State Social Security Administrators to help them perform their responsibilities?

Interpretations of the Social Security Act, *the State Agreement and pertinent modifications, as they apply to the public employer at issue.*

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 in the Statistical Abstract, U.S. Bureau of the Census. *To identify the specific entities, locate a list of State departments in your State and identify who works with employers. Start with the obvious such as the State Department of Labor and Employment and contact others such as the Department of Local Affairs (Intergovernmental Agency). Determine if any government types are not included in your existing lists and gather lists from the appropriate source(s), such as school districts.*

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The Social Security Administration (SSA)

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Overview

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The Social Security Administration (SSA) administers the Old-Age, Survivors, and Disability Insurance programs. SSA also issues Social Security numbers to individuals and keeps track of name changes and other pertinent information reported to the district Social Security offices. Various other services are provided to help maintain accurate records of wages, general record keeping and reporting. SSA investigations are initiated as a result of an individual's questioning earnings posted to or missing from an earnings record, or as a result of a benefit claim with questionable reporting of earnings. All types of claims are handled by the district offices. They also help individuals to understand and comply with the provisions of the *Social Security Act* (Act) which affect them when they are receiving benefits. District office representatives are available to individuals and groups to talk about the provisions of the Act.

SSA maintains records for each person with covered earnings who is assigned a Social Security number. The earnings record contains all of a worker's earnings in covered employment regardless of where or by whom the worker may have been employed. It also contains self-employment earnings for an individual. The earnings shown on these records are used to determine eligibility for, and to compute the amount of benefits payable to, an individual. In order that the proper eligibility determinations may be made, all records maintained by SSA must be complete and accurate. These records include Forms W-2, self employment earnings information obtained by IRS. SSA is responsible for the interpretation of the provisions of the Act.

SSA, under the direction of the Commissioner of Social Security, administers a national program of contributory social insurance financed through the Social Security trust funds. When earnings stop or are reduced because the worker retires, dies or becomes disabled, monthly cash benefits are paid to partially replace part of the earnings the family has lost. Principal programs include the Old-Age, Survivors and Disability Insurance (OASDI) programs which provides monthly benefits to retired and disabled workers, their spouses and children, and to survivors of insured workers.

Part of the contributions go into a separate hospital insurance trust fund, so that when workers and their dependents become 65 years old they will have help with their hospital bills. They may also elect to receive help with doctor bills and other medical expenses by paying a percentage of supplementary medical insurance premiums, while the Federal government pays the remainder. Together, these two programs are referred to as Medicare. Under certain conditions, Medicare protection also is provided to people who are receiving Social Security or railroad retirement monthly benefits based on a disability. The Health Care Financing Administration (HCFA) is responsible for administering the Medicare program. SSA is responsible for determining an individual's eligibility for Medicare and for maintaining Medicare data on the earnings records. By agreement with the Department of Labor, SSA is also involved in certain aspects of the administration of the black lung benefits provisions of the *Federal Coal Mine Health and Safety Act* of 1969.

Organization

SSA operations are decentralized to provide appropriate services at the local level. The United States is divided into 10 regions, each headed by a Regional Commissioner. The Regional Commissioner is the principal agency representative at the regional level, responsible for effective administration contact with Federal agencies, State disability determination services, and State welfare agencies. Regional Commissioners implement national operational and management plans for providing services directly to the public

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and coordinate regional operations so that they are effective and consistent with national and regional requirements, as well as systems and policy directives.

Each region contains, under the overall direction of the Regional Commissioner, a network of field offices and teleservice centers, which serve as the contact between the SSA and the public. These installations:

- inform people of the purposes and provisions of programs and their rights and responsibilities thereunder;
- assist with claims filed for retirement, survivors, health or disability insurance benefits, black lung benefits, or supplemental security income;
- develop and adjudicate claims;
- assist certain beneficiaries in claiming reimbursement for medical expenses;
- conduct development of cases involving earnings records, coverage and fraud-related questions;
- make rehabilitation services referrals; and
- assist claimants in filing appeals on SSA determinations of benefit entitlement or amount.

Social Security Administration Responsibilities

Public employers should initially discuss issues and questions with their State Social Security Administrator. If additional assistance is needed regarding coverage, the appropriate parallel Social Security office should be contacted in writing. (See list on next page.) Public employers who have questions regarding magnetic media should contact the appropriate regional coordinator listed in Chapter 10 (Public Employers). Questions that begin, "Do we have to pay taxes on...?" should be directed to the IRS.

Regional Office (RO)

The Regional Office staff works under the direction of the Regional Commissioner. 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 RO:

- maintains file of original agreements and modifications;
- reviews and executes modifications for coverage;
- reviews and executes modifications removing legally dissolved entities from an agreement;
- reviews PSSO determinations regarding coverage and wage issues referring those questions to the Office of Program Benefits Policy where no policy has been established or the present policy requires a change which may have national impact;
- reviews and executes re-extension agreements for periods prior to 1987 (until closed out); and
- handles inquiries and answers questions about magnetic media reporting and paper reporting of wages.

Parallel Social Security Office (PSSO)

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The PSSO is the on-site representative of the SSA under the leadership of the Regional Commissioner. Its principal responsibilities are to:

- assist in drafting agreements and modifications and conducting a preliminary review of these documents;
- follow-up with States regarding existing reextension agreements to extend time limitations; and
- conduct day-to-day negotiations with the States on State and local coverage and reporting issues, including making wage and coverage determinations where appropriate.

Parallel Social Security Office Contacts

Direct inquiries to: District Manager, Social Security Administration

Region 1

Connecticut
One Corp Center
20 Church Street, 9th Floor
Hartford, CT 06103

Maine
Federal Building
40 Western Avenue, Room G-26
Augusta, ME 04330

Massachusetts
10 Causeway St, Rm 148 1st Fl
Boston, MA 02222

New Hampshire
Concord Center
10 Ferry Street, Rm 208
Concord, NH 03301

Rhode Island
380 Westminister St, 3rd Floor
Providence, RI 02903

Vermont
33 School St
Montpelier, VT 05602

Region 2

New Jersey
Capitol Center Building
50 East State Street, 2nd Floor
Trenton, NJ 08608

New York
Federal Building
1 Clinton Ave, Rm 430
Albany, NY 12207

Puerto Rico
Room 200, 2nd Floor
65th INF & Barbosa Ave
Rio Piedras, PR 00923

St. Thomas, Virgin Isles
Federal Office Building
5500 Veterans Drive, Rm 113
Charlotte Amalie, VI 00802

Region 3

Delaware
Federal Building
300 S New Street
Dover, DE 19904

Maryland
500 N Calvert St.
Baltimore, MD 21202

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Parallel Social Security Office Contacts

Direct inquiries to: District Manager, Social Security Administration

Pennsylvania
Federal Building
228 Walnut Street
Harrisburg, PA 17108

Virginia
718 E Franklin Street
Richmond, VA 23219

West Virginia
1206 Quarrier Street
Charleston, WV 25301

Region 4

Alabama
340 Montgomery Street
Montgomery, AL 36195

Florida
227 N Bronough, Suite 2070
Tallahassee, FL 32301

Georgia
795 Peachtree St NE, Suite 310
Atlanta, GA 30308

Kentucky
330 W Broadway, 2nd Floor
Frankfort, KY 40601

Mississippi
100 W Capitol Street, Room 401
Jackson, MS 39269

North Carolina
4405 Bland Road
Raleigh, NC 27609

South Carolina
Strom Thurmond Federal Building
1835 Assembly St, 2nd Floor
Columbia, SC 29202

Tennessee
1720 West End Ave
Nashville, TN 37203

Region 5

Illinois
2715 West Monroe St
Springfield, IL 62704

Indiana
575 N Pennsylvania St, Room 617
Indianapolis, IN 46204

Michigan
5015 South Cedar, Suite 150
Lansing, MI 48910

Minnesota
Federal Building
316 Robert St, Room 185
St. Paul, MN 55101

Ohio
Federal Building
200 North High Street, Room 225
Columbus, OH 43215

Wisconsin
6502 Odana Rd
Madison, WI 53719

Parallel Social Security Office Contacts

Direct inquiries to: District Manager, Social Security Administration

Region 6

Arkansas
Federal Building
700 W Capitol Street, Rm 1433
Little Rock, AR 72201

Louisiana
350 N Donmoor Ave
Baton Rouge, LA 70806

New Mexico
1911 Fifth Street, Suite 101
Santa Fe, NM 87505

Oklahoma
Shephard Mall
2615 Villa Prom
Oklahoma City, OK 73107

Texas
903 San Jacinto Blvd, Suite 102
Austin, TX 78701

Region 7

Iowa
Federal Building
210 Walnut Street, Room 293
Des Moines, IA 50309

Kansas
1201 SW Van Buren St
Topeka, KS 66612

Missouri
3702 W Truman Blvd, Suite 115
Jefferson City, MO 65109

Nebraska
100 Centennial Mall N, Room 191
Lincoln, NE 68508

Region 8

Colorado
1616 Champa Street, 4th Floor
Denver, CO 80205

Montana
301 South Park, Room 138
Helena, MT 59626

North Dakota
1025 N 3RD Street
Bismarck, ND 58501

South Dakota
Federal Building
200 4th Street, Room 105
Huron, SD 57350

Utah
46 W. 300 S., Suite 100
Salt Lake City, UT 84101

Wyoming
1750 Westland Rd
Cheyenne, WY 82001

Region 9

Arizona
7227 N 16th Street, Suite 190
Phoenix, AZ 85020

California
8351 Folsom Boulevard
Sacramento, CA 95826

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Parallel Social Security Office Contacts

Direct inquiries to: District Manager, Social Security Administration

Hawaii
Federal Office Building
300 Ala Moana Blvd, Rm 1123
Honolulu, HI 96850

Nevada
1175 Financial Blvd
Reno, NV 89502

Region 10

Alaska
222 W 8th Avenue, Room A11
Anchorage, AK 99513

Idaho
3210 Elder St
Boise, ID 83705

Oregon
Suite 530 Center Street NE
Salem, OR 97301

Washington
3700 Martin Way East, Suite 108
Olympia, WA 98506

Central Office

The Office of Program Benefits Policy (OPBP) and the Office of Systems Requirements (OSR) are the Central Office components primarily responsible for administering the State and local coverage program. Organizationally, they are located under the Deputy Commissioner for Programs and the Deputy Commissioner for Systems.

Office of Program Benefits Policy (OPBP)

This office plans, develops, evaluates, and issues operational policies and procedures concerning coverage and wage questions related to Section 218 of the *Social Security Act*. As lead component for all State and local matters, OPBP:

- interprets laws and regulations relating to State and local coverage, wage and reporting requirements;
- makes policies in the State and local coverage, wage reporting and contributions liability areas;
- develops procedures and instructions for coverage and wage issues and reporting policy;
- administers policy for payments and claims for credit and check requests for pre-1987 periods;
- makes decisional recommendations regarding 218(s) and (t) cases for pre-1987 periods; and
- maintains the State and Local Coverage Handbook (SLCH).

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:

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- 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, e.g., 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 Records Operations (OCRO)

This office processes all paper and tape wage and correction reports. Specific areas of responsibility for State and local include receiving and controlling modifications, and assigning identifying numbers. For pre-1987 periods, OCRO:

- receives, controls and accounts for all outstanding wage reports and contributions including interest,
- prepares, maintains and furnishes trust fund reconciliation information,
- prepares and issues audit statements on wage reports and corrections,
- controls statute of limitation cases;
- provides information on outstanding overpayments and underpayments to States; and
- assigns and documents IRD 69 numbers for new coverage.

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 which affects SSA programs and reviews 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.

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Office of Systems Requirements (OSR)

Areas of responsibility for pre-1987 tax years include:

- Automated State and local reconciliation system,
- Trust fund accounting of State and local contributions,
- Deposit procedures, including wire transmission of deposits,
- Medicare for State and local employees not covered by FICA,
- State and local internal adjustments, and
- Audits of State and local corrections.

Questions

1. Where should questions on tax liability which begin "Do we have to pay Social Security taxes on....?" be directed?

Questions related to tax liability should be directed to IRS.

2. What information can be provided by SSA to State Social Security Administrators to help them perform their responsibilities?

Interpretations of the Social Security Act, *the State Agreement and pertinent modifications, as they apply to the public employer at issue.*

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The Internal Revenue Service (IRS)

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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 functions through its headquarters in Washington and its regional, district and local offices.

IRS is responsible for administering and enforcing the *Internal Revenue Code* (IRC) and related statutes, except those relating to alcohol, tobacco, firearms and explosives. Its mission is to collect the proper amount of tax revenue at the least cost to the public, and in a manner that warrants the highest degree of public confidence in the Service's integrity, efficiency and fairness. To achieve that purpose, the IRS:

- strives to achieve the highest possible degree of voluntary compliance in accordance with the tax laws and regulations;
- advises the public of their rights and responsibilities;
- determines the extent of compliance and the causes of noncompliance;
- administers and enforces the tax laws; and
- searches for and implements new, 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 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 revenues collected is the individual income tax and the social insurance and retirement taxes, with other major sources being the corporation 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 16th amendment of the U.S. Constitution.

Organization

The IRS organization is designed for maximum decentralization, consistent with the need for uniform interpretation of the tax laws and efficient utilization of resources. There are three organization levels: the National Office; Regional Offices; and District Offices. There are also other field offices that are part of the National Office such as Service Centers and Computing Centers.

Headquarters Organization

The National Office, located in Washington, D.C., develops nationwide policies and programs for the administration of the IRC and provides overall direction to the field organization. The Martinsburg Computing Center in Martinsburg, WV, and the Detroit Computing Center in Detroit, MI, also are assigned to the National Office.

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Field Organization

As a decentralized organization, most agency personnel and activities are assigned to field installations. IRS, in an effort to streamline management including support of field operations, is undergoing a reorganization. IRS has reduced the seven regional offices to four and is reducing the 63 district offices to 33. Shown below are the new regions and district locations.

Regional Offices. There are four Regional Offices, each headed by a Regional Commissioner, which provide guidelines and evaluate the operations of District Offices and Service Centers.

Region (Office)	District (Office)
Midstates (Dallas) Arkansas, Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, Wisconsin	**Kansas-Missouri (St. Louis)**: St. Louis and Wichita **Houston** **Illinois (Chicago)**: Chicago and Springfield **North Central (St. Paul)**: Aberdeen, Fargo and St. Paul **North Texas (Dallas)** **Midwest (Milwaukee)**: Des Moines, Milwaukee and Omaha **South Texas (Austin)** **Arkansas-Oklahoma (Oklahoma City)**: Little Rock and Oklahoma City
Northeast (Manhattan) Connecticut, Maine, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, Vermont	Brooklyn **Manhattan** **Michigan (Detroit)** **New Jersey (Newark)** **New England (Boston)**: Augusta, Boston, Burlington and Portsmouth **Ohio (Cincinnati)**: Cincinnati and Cleveland **Pennsylvania (Philadelphia)**: Philadelphia and Pittsburgh **Connecticut-Rhode Island (Hartford)**: Hartford and Providence **Upstate New York (Buffalo)**: Albany and Buffalo

Region (Office)	District (Office)
Southeast (Atlanta) Alabama, Delaware, District of Columbia, Florida, Georgia, Indiana, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia	**North-South Carolina (Greensboro)**: Columbia and Greensboro **Gulf Coast (New Orleans)**: Birmingham, Jackson and New Orleans **Kentucky-Tennessee (Nashville)**: Louisville and Nashville **Georgia (Atlanta)** **Indiana (Indianapolis)** **Delaware-Maryland (Baltimore)**: Baltimore and Wilmington **North Florida (Jacksonville)** **South Florida (Fort Lauderdale)** **Virginia-West Virginia (Richmond)**: Parkersburg and Richmond
Western (San Francisco) Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming	**Central California (San Jose)** **Los Angeles** **Northern California (Oakland)**: Sacramento and San Francisco **Pacific Northwest (Seattle)**: Anchorage, Honolulu, Portland and Seattle **Rocky Mountain (Denver)**: Boise, Cheyenne, Denver, Helena and Salt Lake City **Southern California (Laguna Niguel)** **Southwest District (Phoenix)**: Albuquerque, Las Vegas and Phoenix
International	**Puerto Rico (San Juan):** Virgin Islands (Charlotte Amalie)

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District Offices. Programs of the district office include: taxpayer service, examination, collection, criminal investigation, resources management, and in some districts, pension plans and exempt organizations and/or a district office research and analysis (DORA) division. Functions performed are: assistance and service to taxpayers, determination of tax liability by examination of tax returns, determination of pension plan qualification, collection of delinquent returns and taxes, and investigation of criminal and civil violations of internal revenue laws. Directors are responsible for the deposit of taxes collected by the district and for initial processing of original applications for admission to practice before the IRS and renewal issuances for those practitioners already enrolled. Local offices may be established to meet taxpayer needs and agency workload requirements.

Service Centers. Each service center processes tax returns and related documents and maintains accountability records for taxes collected. Programs include the processing, verification and accounting control of tax returns; the assessment and certification of refunds of taxes; and administering assigned examination, criminal investigation and collection functions.

International. The Office of International Programs (National Office) is responsible for the operations of the overseas post networks, program oversight and planning for the International Enforcement Program in addition to numerous other duties. The San Juan, Puerto Rico office has field responsibility for Puerto Rico and Island Territories (Virgin Islands) enforcement activities.

Office Of Chief Counsel. The Office of Chief Counsel of IRS is a Treasury Department (legal division) unit. Chief Counsel furnishes legal advice to the Commissioner of IRS on matters pertaining to administration and enforcement of Internal Revenue laws. Each regional counsel is subject to general supervision of the Chief Counsel. District Counsel provides support to each District Director.

Litigation in Tax Court is conducted by the Office of Chief Counsel. Using the recommendations of Chief Counsel, the Department of Justice conducts other Federal tax litigation (i.e., in the Supreme Court and district, claims, and circuit courts).

Appeals. There are appeals offices in each region. These offices have authority to represent the Commissioner of IRS in matters concerning determination of certain taxes which include Employment Taxes. If, at the conclusion of an examination, the taxpayer does not agree with the adjustments proposed, the examiner prepares a complete examination report fully explaining all proposed adjustments. The taxpayer is sent a copy of the examination report under cover of a transmittal (30-day) letter, providing a detailed explanation of the alternatives available, including consideration of the case by an Appeals Office, and requesting the taxpayer to inform the District Director within the specified period, of the choice of action.

Questions

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

IRS

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.

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 sharing of 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.

3. What information can IRS share with the 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 FICA tax liability.

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Public Employers

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State Government

Authority

The states have primary responsibility for many aspects of government. Amendment X of the U.S. Constitution reserves all powers to the states or to the people of the nation that are not delegated by the constitution nor prohibited by it for the states. Often the state and federal government work together to provide services. 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 providing services the federal and state governments work as partners. Often the federal government provides most of the funding while the state primarily provides distribution though it varies from program to program. 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*)

Definition: *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.*

Local Government

Local governments are different from state and federal governments because they are 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 at least one characteristic in common: they all have a republican form of government. The types of local governments vary: borough, city, county, township, village, etc.

Authority

The amount of authority local governments have varies almost as much as the types of local governments. Basically, 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.

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Local governments generally provide services if needed by the local area (such as building a bridge over a nearby 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 which local governments take primary responsibility in providing include:

- making sure that drinking water is safe,
- protecting public health and safety,
- building and repairing local roads and streets,
- providing police and fire protection,
- collecting garbage,
- maintaining schools,
- running or helping to run 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 87,929 local governments existed nationwide as listed on the following pages.

Definition: *A political subdivision for purposes of a Section 218 Agreement includes an instrumentality of a State, one or more of its political subdivisions, or a State and one or more of its political subdivisions. It is a separate legal entity of a State which usually has specific governmental functions. A political subdivision ordinarily includes a county, city, town, village, school district and other similar governmental entities. (Contact the State Social Security Administrator to determine an entity's coverage status for Section 218 purposes.)*

What Are Interstate Instrumentalities?

There is FICA liability with regard to wholly owned instrumentalities. In determining whether an organization is a wholly owned instrumentality of 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 vested in public authority or authorities;
5. If express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and

Local Governments by Type—State
(Unofficial Census Estimates for 1997)

State	Total	County	Municipal	Township	School District	Special Districts
United States . . .	**87,929**	3,043	19,372	16,633	13,758	35,123
Alabama	**1,137**	67	445		127	498
Alaska	**175**	12	149			14
Arizona	**641**	15	87		232	307
Arkansas	**1,535**	75	491		311	658
California	**4,572**	57	470		1,069	2,976
Colorado	**1,908**	62	267		180	1,399
Connecticut	**585**		30	149	17	389
Delaware	**337**	3	57		19	258
DC	**2**		1			1
Florida	**1,082**	66	394		95	527
Georgia	**1,336**	156	536		180	464
Hawaii	**21**	3	1			17
Idaho	**1,157**	44	201		114	798
Illinois	**6,873**	102	1,290	1,433	946	3,102
Indiana.	**3,201**	91	569	1,008	294	1,239
Iowa.	**1,883**	99	950		440	394
Kansas	**3,955**	105	627	1,370	324	1,529
Kentucky	**1,386**	119	435		176	656
Louisiana.	**467**	60	302		66	39
Maine	**834**	16	22	467	98	231
Maryland	**422**	23	156			243
Massachusetts . .	**865**	12	44	307	85	417
Michigan	**2,777**	83	534	1,242	581	337
Minnesota	**3,519**	87	852	1,796	408	376
Mississippi	**944**	82	294		164	404
Missouri	**3,456**	114	947	324	537	1,534

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Local Governments by Type—State
(Unofficial Census Estimates for 1997)

State	Total	County	Municipal	Township	School District	Special Districts
Montana	**1,132**	54	128		374	576
Nebraska	**2,902**	93	534	455	681	1,139
Nevada	**203**	16	19		17	151
New Hampshire	**585**	10	13	221	166	175
New Jersey	**1,423**	21	324	242	551	285
New Mexico	**892**	33	99		96	664
New York	**3,433**	57	616	929	686	1,145
North Carolina	**952**	100	527			325
North Dakota	**2,768**	53	363	1,342	236	774
Ohio	**3,597**	88	941	1,310	666	592
Oklahoma	**1,798**	77	589		577	555
Oregon	**1,517**	36	240		265	976
Pennsylvania	**5,155**	66	1,023	1,546	515	2,005
Rhode Island	**119**		8	31	4	76
South Carolina	**716**	46	270		86	314
South Dakota	**1,810**	66	310	958	177	299
Tennessee	**947**	93	341		14	499
Texas	**4,777**	254	1,178		1,092	2,253
Utah	**685**	29	229		40	387
Vermont	**692**	14	50	237	279	112
Virginia	**483**	95	231			157
Washington	**1,826**	39	275		296	1,216
West Virginia	**712**	55	232		55	370
Wisconsin	**3,066**	72	583	1,266	442	703
Wyoming	**661**	23	97		56	485

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6. The degree of financial autonomy and the source of operating expenses. An instrumentality owned by more than one state can be a state instrumentality. (See Rev. Rul. 57-128.)

An instrumentality of a state or a political subdivision of a state is an organization chartered by the state, operated for public purposes and expressly declared by statute to be a political subdivision of a state. Questions concerning the status of an interstate instrumentality, for FICA purposes, should be directed to the IRS.

Note: For purposes of a Section 218 Agreement, an interstate instrumentality has the status of a State. Questions concerning the status of an interstate instrumentality should be directed to the Parallel Social Security Office. *See page 8-5.*

Instrumentalities Qualifications

Schools, hospitals and libraries may not be state or local government entities. State sponsorship of an organization, state regulations of its activities, and the fact that its employees participate in a state, county or municipal retirement system or that public funds are provided for its buildings and/or operations are only factors in determining whether or not an organization is a state instrumentality. If it is essentially under private ownership and control, or if under private ownership under temporary state control, it won't qualify as a state instrumentality.

Associations formed for conservation, protections and promotion, even though they carry out a public purpose, may not rise to the level of state instrumentalities. Thus the following associations may not be state instrumentalities: soil and water conservation districts, fire association that protects forest land and associations that promote a state or municipality. (Documentation that shows statutory authority under which instrumentality was established is required for status determination.)

Soil and Water Conservation Districts. Soil and water conservation districts whose revenues are principally generated from fees collected from the land owners within the district don't qualify as state instrumentalities.

➔ *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 furnishes the district with certain 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 is a political subdivision of the State. [Rev. Rul. 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 has authority to assist private individuals in forming conservation districts but does not have the power to operate them. The private individuals have complete control over the corporate operations, revenue and expenditures. Therefore, the soil and water conservation district is not a wholly owned instrumentality or political subdivision of the State of Connecticut. [Rev. Rul. 69-453, CB 1969-2, 182]*

Fire Associations that Protect Forest Land. Associations that are not an arm of the state but formed pursuant to state law for protection purposes aren't state instrumentalities.

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➔ *Example: A fire association was organized pursuant to an Oregon State law that requires 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 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. [Rev. Rul. 70-483, CB1970-2, 201]*

➔ *Example: Under the laws of the State of Pennsylvania, townships have the authority to purchase, out of the general township fund, fire engines and fire apparatus for the use of the township and to appropriate moneys to fire companies located in the township in order to secure fire protection for the township. Members of volunteer fire departments organized under the laws of Pennsylvania are employees of the political subdivision. [Rev. Rul. 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 state 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 prevented from being a state instrumentality. The Leagues' 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 special statute for the incorporation of a league of this nature as an instrumentality of political subdivisions. [Rev. Rul. 65-26, 1965-1, 444]*

Note: Some State statutes specifically create similar associations as political subdivisions. A review of the establishing legislation is required for status determination.

Wages and Employment Taxes

Section 3121(a) of the *IRC* 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 FICA purposes are: salaries, fees, bonuses and commissions. It is immaterial whether the payments are based on the hour, week, month, year, piecework, or on a percentage basis.

As an employer, Social Security and Medicare taxes are levied on both the State or local entity and its employees. The State or local entity must collect and pay the employee's part of the taxes and it must pay a matching amount. Beginning in 1994, no wage base limit exists for Medicare tax.

The limitation on wages for Social Security purposes applies to the remuneration received from each employer and not to the aggregate remuneration received from all employers. Consequently, if an employee works for more than one employer in one calendar year, excess Social Security taxes may be withheld. In order to recover the excess Social Security 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 reporting wages paid to employees up to the maximum. Medicare has no similar maximum limits.

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For the purpose of determining responsibility for reporting wages up to the maximum, the state is considered to be one employer and each political subdivision is considered to be a separate employer. An employee who transfers from one state agency to another during a calendar year does not change employers and should only be reported for the maximum for Social Security purposes. An employee who transfers from a state agency to a political subdivision, a city or county, has changed employers and should be reported for the maximum by each state entity.

FICA Tax Rates

Under the Federal Insurance Contributions Act (FICA), Social Security and Medicare taxes are imposed on the wages of each employee. The combination of the two taxes makes up the amount of tax to be withheld from an employee's wages each time a wage payment is made by an employer. The *IRC* also imposes taxes on employers. The rate of tax on the employer is the same rate of tax as on the employee. The tax rate is computed on the amount of wages paid to the employee. These taxes are computed and reported quarterly on Form 941 by the employer.

Noncash Payments

Generally noncash payments deemed to be wages are subject to FICA. The wages paid in a medium other than cash should be computed on the basis of the fair market value to the employee of such items 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 for one period for employment (or potential employment) in an earlier period. For Social Security coverage and benefit purposes, all back pay, whether or not under a statute, is wages except amounts specifically designated otherwise, e.g., damages, interest, penalties, and legal fees. For taxes purposes, back pay is treated as wages in the year received. However, 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. See IRS Publication 957 for more information.

Business Expenses

Payments to employees for travel and other necessary expenses of a state entity's business generally are wages if the employee is not required to, or does not substantiate timely those expenses with receipts; or if the employer advances an amount to the employee for business expenses and the employee is not required to, or does not return timely, any amount she/he does not use for state entity business expenses. Allowances at the federal rates for mileage and for lodging, meal and incidental expenses are deemed substantiated. See IRS Publication 15 for more information.

Cafeteria Plans

Cafeteria plans, including flexible spending arrangements, are benefit plans under which all participants are employees who can choose from among cash and certain qualified benefits. If the employee elects qualified benefits, employer contributions are excluded from his/her 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

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group-term life insurance that is includible in income only because the insurance exceeds $50,000 of coverage is considered a qualified benefit under a special rule.

Generally, qualified benefits under a cafeteria plan are not subject to FICA 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 535 for further details.

Fringe Benefits

Generally, fringe benefits must be included in an employee's gross income. The benefits are subject to income and FICA taxes. Fringe benefits include cars for personal use, tickets to entertainment or sporting events, etc. Some fringe benefits are nontaxable. (See IRS Publication 15-A for further details.)

Meals And Lodging

The value of meals and lodging are not wages **if** furnished:

1. on the business premises of the employer, **and**
2. for the convenience of the employer, **and**
3. for lodging—the employee is required to accept lodging as a condition of employment.

See IRS Publication 15 for more information.

Reporting Deceased Employee's Wages

If an employee dies during the year, you must report the accrued wages, vacation pay, and other compensation paid after the date of death. If you made the payment in the same year the employee died, you must, if the services are covered, withhold Social Security and Medicare taxes on the payment and report them on the employee's Form W-2. This will ensure the deceased employee's survivors receive the benefit of proper Social Security and Medicare credits. On the Form W-2, show the payment as Social Security wages (box 3) and Medicare wages and tips (box 5) and 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.

Whether the payment is made in the year of death or after the year of death, you also must report it in box 3 of **Form 1099-MISC**, Miscellaneous Income, as a payment to the estate or beneficiary. Use the name and TIN of the estate or beneficiary on Form 1099-MISC. (See Rev. Rul. 86-109, 1986-2 C.B. 196.)

Sick Pay

Sick pay is an amount paid to an employee because of sickness or injury. Such amounts are sometimes paid by a third party, such as an insurance company or employee trust. In either case, these payments are subject to Social Security and Medicare taxes. These payments are also subject to income tax withholding if paid by the employer. If the state entity makes the payments, withholding is on the basis of the employee's Form W-4. If a third party makes the

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payments, the employee may request income tax withholding by giving the third party payer 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 or Medicare:

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 information.

Vacation Pay

Vacation pay is wages and should be reported for Social Security purposes.

Federal Unemployment Tax Act (FUTA)

Unemployment Insurance (UI) is for workers who lose their job through no fault of their own. The State and the political subdivisions within the State are exempt from paying the federal tax, under the *Federal Unemployment Tax Act* (FUTA). However, State and local government employees, with certain exceptions, must be covered for **state** unemployment insurance purposes. Each State must determine whether an individual is an employee or an independent contractor.

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 tax.

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 so the employee can claim the appropriate number of withholding allowances and identify marital status. After filling out the Form W-4, the employee signs and returns it to the employer. 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

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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. One way is to use the wage bracket withholding tables. Another way is to determine the amount of federal income tax withholding by the percentage method tables. Both methods are found in IRS Publication 15. Alternative methods of withholding are explained in IRS Publication 15-A, e.g., the annualized wages, average estimated wages, cumulative wages, and part-year employment methods..

The federal income tax withholding tables are organized by marital status and payroll period. Determine which table applies to the employee by matching the employee's marital status and the state entity's payroll period with the appropriate table. Next, look for the row which includes the employee's gross pay for the period in the "at least" and "but less than" columns of the table. Follow the row across to the column showing the number of allowances claimed by the employee. Withhold this federal income tax amount from your employee's wage payment.

The other way to determine the amount of federal income tax withholding is the percentage method. To use this method, use the tables and follow the steps described in IRS Publication 15 and summarized below:

1. find the amount of one withholding allowance which goes with the payroll period covered by the wage payment.
2. multiply the amount from number 1 by the number of withholding allowances claimed on the employee's Form W-4.
3. subtract from the employee's wages the amount computed in number 2.
4. calculate the tax on the amount determined in number 3 by using the tables for percentage method of withholding.

Either method can be chosen in addition to the alternative methods explained in IRS Publication 15-A. Generally, the first method is easier. However, for high amounts of pay or pay periods not included in the tables, the second method is needed. Other methods may be used if they achieve approximately the same withholding.

Supplemental Wages

This is compensation paid to an employee in addition to the employee's regular wages (e.g., overtime pay, severance pay, awards, backpay, payments for non-deductible moving expenses, etc.).

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 was 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 or not 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 a flat 28 percent. (Higher rates are permitted under the Revenue Reconciliation Act of 1993).

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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.

Regardless of the method used to withhold income tax on supplemental wages, if they are paid to covered employees (under a Section 218 Agreement or mandatory coverage), they are subject to Social Security and Medicare taxes.

Social Security and Medicare Tax Withholding

Social Security and Medicare taxes are levied on both the State and local entity and its employees. The State and local entity must collect and pay the employee's part of the taxes and it must pay a matching amount. These taxes have different tax rates and wage bases. The wage base is the maximum wage that is subject to the tax for the year. See page 10-23 for the wage base for Social Security. Beginning in 1994, no wage base limit exists for Medicare tax.

Employer Identification Number

IRS keeps track of individual taxpayers by using a taxpayer identification number (TIN); the TIN is their Social Security Number. Likewise, State and local entities use Employer Identification Numbers (EINs) to identify their tax returns. EINs should be used on all employment tax returns, information returns and all correspondence with the IRS. Each county, city, school district and other governmental unit will have a unique EIN.

➔ *Example: The City of Y will have a different EIN from the County of Y, because each is a separate entity. This is not the case within the State government. Many of the state agencies, such as the Department of Tourism, may use an EIN assigned to the Department of Finance and Administration. However, some of the larger state agencies, such as the State Highway Department do have a unique EIN.*

When a larger municipality annexes a smaller village or town, or school districts are combined, the EIN number of the annexed area or abolished district should no longer be used, as it is no longer a separate entity. When an unincorporated area becomes incorporated, it is a separate entity and should obtain its own EIN. This may be done by contacting IRS (or SSA) and completing a Form SS-4.

It is important that the EIN is checked for accuracy and completeness on each tax document that is submitted. When an incorrect EIN is used, tax monies are credited or debited to another account causing missed interest or unwanted penalties if not corrected.

Note: EINs beginning with the digits 69 are SSA-assigned employer identification numbers and should not be used to report earnings. Prior to 1987, these numbers were assigned for new modifications for coverage and then used to process wage reports. Although IRS and SSA do not need the 69-numbers, many States have a filing system based upon the 69-number and, therefore, continue to request 69-numbers from SSA for internal recordkeeping purposes.

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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 paycheck, or they can claim the credit on their tax return at the end of the year.

Eligible employees (see IRS Publication 15) who want to get 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 employees who complete a Form W-5.

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, Social Security or Medicare taxes. An advance EIC payment does not change the amount of income, Social Security or Medicare taxes withheld from the employees wages. Add the EIC payment to the employees net pay for the pay period. At the end of the year, show the total advance EIC payments in box 9 for “Advance EIC Payment” of the 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. Subtract this amount from the total taxes (see the specific instructions on the 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. It is encouraged that employees eligible for EIC are notified. Eligible employees may get a refund of the amount of EIC that is more than the tax they owe.

For further information on eligible employees, how to figure advance EIC payments, and how to notify employees, refer to IRS Publication 15.

Form 941 and 941c

Form 941 (Employer’s Quarterly Federal Tax Return) is used to report total wages, wages subject to Social Security, Medicare, and federal income tax and to reflect the total employer tax liabilities.

In preparing the 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 20th, but is not paid until April 5th. In this situation, the employee’s wage payment is included in the second quarter when the payment is made, not the first

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quarter when the work was done. Total wages and compensation entered on line 2 of Form 941 includes all payments to the 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 the Social Security tax must be withheld, line 6a, may differ from total wages. Earnings over the limit are not subject to Social Security tax. However, there are no limits on the earnings subject to Medicare tax on 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.

To correct errors in FICA for Social Security and Medicare taxes from prior quarters, adjustments should be made on line 9 of Form 941 for the quarter in which the error was discovered and the adjustments should be explained 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.
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.

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 30th. 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.

Depositing Taxes

In general, State and local employers must deposit Federal employment taxes by mailing or delivering a check, money order, or cash to an authorized financial institution or Federal Reserve bank. However, some employers are required to deposit by electronic funds transfer. See information on electronic deposit requirements below.

Separate Deposit Requirements for Nonpayroll (Form 945) Tax Liabilities

Separate deposits are required for nonpayroll income tax withholding. Do not combine deposits for Form 941 and Form 945 (Annual Return of Withheld Federal Income Tax) tax liabilities. Generally, the deposit rules for nonpayroll liabilities are the same as for payroll tax liabilities. See the instructions for Form 945 for details.

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Electronic Deposit Requirement

If total deposits of Social Security, Medicare and withheld income taxes were more than $50,000 in 1995, employers must make electronic deposits for all depository tax liabilities that occur after June 30, 1997. Employers required to deposit by electronic funds transfer in prior years, must continue to do so. The Electronic Federal Tax Payment System (EFTPS) must be used to make electronic deposits. Employers required to make deposits by electronic funds transfer may be subject to a 10 percent penalty if they fail to do so. Employers who are not required to make electronic deposits may voluntarily participate in EFTPS. For information on EFTPS, call toll free 1-800-945-8400 or 1-800-555-4477. (These numbers are for EFTPS information only.)

EFT Phase-In Schedule

Threshold Amount	Determination Period	Effective Date
$50,000	01/01/95 to 12/31/95	July 1, 1997
$50,000	01/01/96 to 12/31/96	January 1, 1998
$50,000	01/01/97 to 12/31/97	January 1, 1999

When to Deposit

There are two deposit schedules—monthly or semiweekly—for determining when to deposit Federal employment taxes. These schedules tell when a deposit is due after a tax liability arises (e.g., payday). Prior to 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 during a four-quarter lookback period as discussed below. The deposit schedule is not determined by how often employees are paid.

Lookback Period

A governmental employer's deposit schedule for a calendar year is determined from the total taxes (not reduced by any advance earned income credit payments) reported on Form 941 (line 11) in a four-quarter lookback period. The lookback period begins July 1 and ends June 30. An employer that reported $50,000 or less of employment taxes for the lookback period, is a monthly schedule depositor for the following calendar year. An employer that reported more than $50,000 of employment taxes is a semiweekly schedule depositor.

For more information on depositing taxes, see IRS Publication 15. See IRS Publication 966 for information on the Electronic Federal Tax Payment System.

FTD Fast Facts

If the TOTAL Liability is...	And Payroll Date Is...	Then a deposit must be made:
$50,000 or less during the lookback period	Any time during the month	On or before the 15th of the following month
More than $50,000 during the lookback period	Saturday Sunday Monday Tuesday	On or before the following Friday
	Wednesday Thursday Friday	On or before the following Wednesday

Lookback period: A four quarter period. For 941 filers, July 1 through June 30
$500 Rule: Taxes less than $500 in a qtr. do not have to be deposited; may be paid with a timely filed return.
$100,000 Next Day Rule: $100,000 or more within a deposit period must be deposited on the next banking day.
Accuracy of Deposit Rule: An employer who inadvertently under deposits will not be penalized if the shortfall is:
$100 or less, than 2% of the amount which should have been deposited. (Balance due must be deposited by shortfall make-up date.)
Source: IRS Document 9080

FTD Penalty (The four tier penalty rates are still in effect.)

Description of Deposit	Rate
1-5 days late	2%
6-15 days late	5%
More than 15 days late, but paid by the 10th day after notice and demand. Notice and demand date is the assessment date (23C date). Amounts paid directly to the IRS when a deposit was required or deposited using Form 8109 when required to deposit by electronic funds transfer (refer to $500 Rule exception).	10%
Taxes still unpaid after the 10th day following notice and demand for payment.	15%

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Wage Reporting

Employers file wage and employment tax withholding information with IRS on Form 941 (Employer's Quarterly Federal Tax Return), and Schedule H (Household Employment Taxes) attached to Form 1040 yearly, or Form 943 (Employer's Annual Tax Return for Agricultural Employees). These forms show gross wages paid and taxes withheld. After the calendar year ends, employers prepare individual employee reports on Forms W-2 (Wage and Tax Statements) under cover of a 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 copies (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 magnetic media reports (or by electronic filing) together with paper Form 6559 (Transmitter Summary of 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 with IRS on Forms 941, Schedule H 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 the employer if less wages were reported to SSA than 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 a magnetic media filing or other wage report processing problem, the employer may contact a wage reporting specialist (see list on page 10-19) or call 1-800-772-6270 for earnings report technicians' help.

Medicare Qualified Government Employment (MQGE)

Employers must file a separate Form W-2 for each employee subject to Medicare-only withholding for the entire year. MQGE Forms W-2 are filed separately from Forms W-2 having full FICA wages. MQGE Forms W-2 must be transmitted with a covering Form W-3 with "Medicare Govt. Emp." checked in box b.

Employees Covered for MQGE and FICA

Some state and local employees may, however, be subject to both Medicare-only withholding and full FICA 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 Medicare wages and taxes from BOTH positions in box 5 and box 6. For full-FICA employment, Social Security wages and taxes are entered in box 3 and box 4. (SSA prefers that this method be used to reduce errors.)
2. use a separate Form W-2 for each withholding category, i.e., one Form W-2 would include wage data from the Medicare-only position and a second Form W-2 would include Social Security and Medicare wage data from the positions with full FICA coverage.

Regional Magnetic Media Coordinators

Region	Coordinator	Region	Coordinator
Region 1 Connecticut Maine Massachusetts New Hampshire Rhode Island Vermont	Don Wilson Boston, MA (617) 565-2895	**Region 6** Arkansas Louisiana New Mexico Oklahoma Texas	Susan Mariano Dallas, TX (214) 767-0928
Region 2 New Jersey New York Puerto Rico Virgin Islands	Terry Maresca New York, NY (212) 264-5643	**Region 7** Iowa Kansas Missouri Nebraska	John Gezich Kansas City, MO (816) 936-5649
Region 3 Delaware Maryland Pennsylvania Virginia West Virginia	Frank O'Brien Philadelphia, PA (215) 597-4632	**Region 8** Colorado Montana North Dakota South Dakota Utah Wyoming	Bill Bates Denver, CO (303) 844-2364
Region 4 Alabama Florida Georgia Kentucky Mississippi North Carolina South Carolina Tennessee	Pat McCarron Atlanta, GA (404) 331-2587	**Region 9** Arizona California Hawaii Guam American Samoa N. Mariana Islands	Bill Brees San Francisco, CA (415) 744-4559
Region 5 Illinois Indiana Michigan Minnesota Ohio Wisconsin	Paul Dieterle Chicago, IL (312) 353-6717	**Region 10** Alaska Idaho Oregon Washington	Tim Beard Seattle, WA (206) 615-2125

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How SSA Processes Wage Reports

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

- balancing and validation programs to determine if 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.

Verifying Employee Names and SSNs

After wage reports have been entered into SSA's system, each employee name and 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 employee is asked to provide corrected name and SSN information to SSA. If the wage report does not show a usable address for the employee, the employer is contacted for the correct information. Once resolved, SSA posts the reported earnings to the employee's record.

To verify up to 5 employee SSNs, employers may telephone SSA at 1-800-772-1213. Larger verification requests (up to 50), can be made in writing to the attention of the manager of the local SSA office for the employer. For higher volume verification processing, employers are required to register with SSA; for details, contact the SSA Division of Operations Support at 1-410-965-7140.

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) for verifying 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 book stores. For questions not addressed in the handbook, contact INS at 1-202-633-4483 or mail questions to:

U.S. Immigration and Naturalization Service
Office of Employer and Labor Relation
425 I St. N.W.
Washington, D.C. 20536

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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.

If the only correction is to the employee's name or Social Security number, file only a W-2c. If the employee has a name change, the employee must notify SSA and request a new Social Security card. If any other corrections are made, both Form W-2c and Form W-3c must be filed.

Occasionally, a correction to Form W-2 information is needed before filing such information with SSA, but after providing the employee with a copy of the Form W-2. If the only correction is to the employee's name or Social Security number, the employee must correct these entries with pen on the employee's copy of Form W-2. The Form W-2 information to be filed with the SSA must be corrected by the employer before it is filed. If any other information is corrected, the employee should be given corrected copies to Form W-2. "Reissued Statement" must show at the top of the Form W-2 with the correct information.

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 with multiple Forms W-2c.

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 account and result in IRS assessing penalties for failure to file correct reports.

Failure to use IRS and SSA mailing labels for reports. IRS provides mailing labels with Publication 393 (Federal Employment Tax Forms) which are to be used to identify paper Form W-2 reports for SSA processing. SSA includes mailing labels with Technical Instruction Bulletin No. 4 to identify magnetic media 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 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 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.

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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 (1) SSA 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 more 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.

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

Magnetic Media Reports

Failure to file Form 6559 (Transmitter Report and Summary of Magnetic Media) with each magnetic media report. Form 6559, or a facsimile, helps SSA identify the employer, the type of report and the year being reported prior to scheduling the report for processing. Multi-reel filers should provide a copy of Form 6559 for each reel.

Dollar totals ("T" Record) omitted on report. Dollar totals are used by SSA to determine if the report is in balance and, if not, to show where the error may be found.

Missing/Incorrect transmitter (Code"A") or Basic Information (Code "B"). This information helps SSA properly identify and control each report. In addition, the "B" Record identifies what kind of equipment was used to prepare the report which helps in resolving any processing problems that may arise.

Employee name entries inconsistent with name code in employee (Code "E"). The order in which employee surnames and given names are shown in the report must agree with the name code in the "E" Record to ensure the employee names match SSA records.

Unreadable Reports. Reports must meet the requirements set out in SSA Pub. No. 42-007, Magnetic Media Reporting (TIB-4), 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.

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 wages under the heading "Special Rules for Various Types of Services and Payments."

NOTES

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 which 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.

The 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.

FICA Tax Rates and Limits

Social Security And Medicare Tax				
	1995	**1996**	**1997**	**1998**
Social Security (OASDI) Tax Information:				
Employee Rate	6.20%	6.20%	6.20%	
Employer Rate	6.20%	6.20%	6.20%	
Maximum Wages*	$61,200	$62,700	$65,400	
Medicare Tax Information:				
Employee Rate	1.45%	1.45%	1.45%	
Employer Rate	1.45%	1.45%	1.45%	
Maximum Wages**	Total Taxable Wages			

*The maximum wages subject to Social Security for the next calendar year are calculated and announced by SSA each fall.
** Public Law 103-82 repealed the Medicare wage base limitation, effective January 1, 1994

Mandatory Social Security Exception

From 1995 through 1999, the threshold mandated by law for exclusion of services of election officials and election workers is less than $1,000 in a calendar year. (***Note***: The worker exclusion amount specified in the Section 218 Agreement remains the same unless the agreement is modified to reflect the higher amount)

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Questions

1. Where do I find instructions on how to correct over or under payments (wage and tax adjustments)?

IRS

Refer to IRS Publication 15.

2. How is the tax reported and when do deposits have to be made?

IRS

In addition to income tax withholding, both the Social Security and Medicare taxes are to be reported on IRS Form 941, Employers Quarterly Federal Tax Return. Because these taxes are now based on different formulas, each tax is reported in a separate box on the form. Separate reporting on IRS Forms W-2 and W-3 is also required. IRS Publication 15 provides a complete explanation of reporting and deposit rules. Employers with $100,000 or more in payroll taxes accumulated during a deposit period must deposit these taxes by the next banking day.

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Social Security and Medicare Benefits

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Social Security and Medicare Benefits

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Under the Federal Insurance Contributions Act (FICA), Social Security and Medicare benefits are financed through FICA taxes paid by employees and their employers. The FICA 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, rises as average wages increase. Medicare Hospital Insurance (HI) taxes are paid on total earnings. The tax rate for OASDI is 6.25 percent. The HI tax rate is 1.45 percent. 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 1997, one credit is earned for each $670 in earnings—up to a maximum of four credits per year.) 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 HI that is 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. Also, 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, a Form 7160 may be filed with the SSA. Based on the common law analysis, SSA would investigate whether an employer-employee relationship had existed for determining the benefits of the claimant.

Retirement

Retirement benefits are payable at age 65 (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 affects people born in 1938 and later.

SSA applies an annual earnings limit to individuals who receive Social Security retirement benefits and continue to work. Thus, workers can earn up to the earnings limit without realizing a reduction in benefits. However, once over the limit, benefits are reduced at a rate determined by the workers age. Earning limits change each year and apply to each person under age 70 receiving Social Security benefits, except people receiving disability benefits, which operate under different rules. Contact SSA to find out what that limit is this year.

A spouse or former spouse may qualify for benefits upon a person'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

NOTES

as early as age 62, or at any age if the spouse is caring for the person's child. The child must be under 16 or disabled and receive benefits on the person'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 parent's Social Security record.

Social Security Benefits				
	1994	**1995**	**1996**	**1997**
Earnings required for one credit	$620	$630	$640	$670
Exempt amounts under annual earnings test:				
Under age 65	$8,040	$8,160	$8,280	$8,640
Age 65-69	$11,160	$11,280	$12,500	$13,500
Age 70 or older	No Limit			

Survivors

If there is a family, 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 for certain family members to receive benefits upon the worker's death. 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.

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.

A spouse's, or surviving spouse's, benefit can be affected by the spouse's age, the spouse's work history and the number of other family members who receive benefits on a person's earnings record. This benefit is permanently reduced if the spouse retires before age 65 and is not caring for a child who receives benefits on a person'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 parent's Social Security record.

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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, the 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

Individuals who are eligible for Social Security are eligible for premium-free Hospital Insurance (HI) benefits when they reach age 65. Also, 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 protection is provided 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.

Eligibility for HI can be 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. Examples of these persons would be governmental employees who did not contribute Social Security or Medicare taxes during their governmental work career or who do not qualify for coverage as a spouse. A public school teacher, covered by a State Teachers Retirement System, whose entire public service was performed at the same board of education would have been 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.

The Medicare program is administered by the Health Care Financing Administration (HCFA). However, SSA enrolls people in the program and disseminates general Medicare information. Claims for payments for services to beneficiaries are processed by insurance companies under contract with the Health Care Financing Administration (HCFA).

Personal Earnings and Benefit Estimate Statement (PEBES)

Since 1995, SSA mails to individuals age 60 or older a statement of their past earnings and estimated future Social Security benefits. SSA plans to send PEBES annually to eligible individuals age 25 and older beginning in the year 2000. In addition, employees at any age may request a benefit estimate by completing Form SSA-7004 (Request for Personal Earnings and Benefit Estimate Statement). These requests should be made by calling 1-800-772-1213. The statements should be examined closely by the employee to ensure all earnings are properly credited. If the earnings are not correctly shown on the statement, the employee should call SSA at 1-800-772-1213.

NOTES

The Medicare portion of PEBES 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 IRS collects Social Security and Medicare taxes. SSA does not keep that record. 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.

Note: Of particular interest for employers is SSA's "Employer Information Package for PEBES (Personal Earnings and Benefit Estimate Statements)," Publication No. 20-003. The publication assists employers with potential employee questions concerning their earnings statements.

Pensions from Work not Covered by Social Security

If a person receives a pension from a job that was not covered by Social Security, such as a State Teachers' Retirement System pension, but the person has enough Social Security credits to be eligible for retirement or disability benefits, a special formula is used to determine a reduced benefit amount.

The special formula affects workers who reach age 62 or become disabled after 1985 and became eligible after 1986 for a monthly pension based in whole or in part on work not covered by Social Security. A person is considered eligible to receive a pension if the requirements of the pension are met, even if the person continues to work.

Windfall Elimination Provision (WEP)

The WEP primarily affects workers who spent most of their careers working for a government agency; but who also worked at other jobs where they paid Social Security taxes long enough to qualify for retirement or disability benefits. In these cases, Social Security benefits will be figured using a formula different from the one used for those who spent most or all of their working years paying Social Security taxes. The windfall elimination formula results in a reduced Social Security benefit.

Before this provision was enacted in 1983, government employees had their benefits computed as if they were long-term, low-wage workers. Thus, they received the advantage of the higher percentage Social Security benefits, in addition to their government pension.

Government Pension Offset (GPO)

The 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 husband or wife.

This was considered unfair because those who receive a spouses's or widow(or)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 benefits of $300 receives only the higher of the two benefits — $400 in this case.

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SSA Publication 05-10045, covering the windfall elimination provision, and SSA Publication 05-10007, discussing government pension offset, are available from the Social Security Administration. Employers assisting in retirement planning are urged to provide copies of these publications to their employees.

Alternative Retirement Plans May Reduce Social Security Benefits

WEP and GPO may reduce benefits for certain government retirees who are eligible for Social Security and a Federal, State or local government pension or alternative retirement plans (such as deferred compensation plans) from a job where they did not pay Social Security taxes.

The SSA has outlined five characteristics used to determine if an alternative retirement plan will be considered a pension plan and subject to the WEP and GPO. An alternative plan is NOT a pension plan when:

- the plan is separate from and in addition to the primary retirement plan, and
- employees voluntarily contribute to the plan, and
- the employer makes no contribution to the plan, and
- 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.

If the alternative plan does not meet the above criteria it will be subject to the WEP and GPO.

Defining a Pension for WEP/GPO Purposes

The Omnibus Budget Reconciliation Act 1990 contained a provision which extended Social Security coverage to those governmental employees who are not members of a retirement system-commonly referred to as mandatory Social Security. The provision does not apply if the employee is already covered under Section 218 of the Social Security Act or is a member of a qualified retirement system as defined by IRS regulations. Mandatory Social Security coverage ceases when the governmental employee becomes a member of an employer provided retirement system that conforms to IRS regulations.

Some employers have opted for other than the standard notion of a retirement system such as a deferred compensation plan — a defined contribution plan that allows participation by governmental employees in lieu of mandatory Social Security coverage. This and other plans raise several questions about the applicability of WEP and GPO.

The first step in determining if GPO and/or WEP will apply is to determine if the periodic or lump sum payment is a pension for GPO/WEP purposes. SSA applies the following general rule to each case when determining if a periodic payment or lump sum benefit from a defined contribution plan (or any other plan) is a pension.

If an employee voluntarily contributes to a plan which 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 employees contributions (plus interest); and withdrawals are not based upon age, length of service or earnings, then the plan is considered a savings plan and is not a pension plan for GPO/WEP purposes.

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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/WEP purposes and the payment will be considered a pension and subject to GPO/ 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 makes no contributions to the plan and the payment from the plan is not based on age, length of service or earnings, While the payment from the retirement system is subject to GPO/WEP provisions, the payment from the deferred compensation plan is not.

GPO Exemption

Some State and local government employees make specific plans to meet the GPO exemption which states, "GPO does not apply if on the spouse's last day of State/local employment, he/she is in a position which was covered by 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 also allow State and local government employees to make decisions which would allow them to meet the criteria for this GPO exemption. A State or local entity may maintain an elective defined contribution plan which 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" their 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 (1) if the employee is still a participant of the plan based on IRS regulations and (2) whether the employee is mandatorily covered for Social Security or via 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 which was covered under Social Security AND also covered by the pension plan is acceptable evidence to show the GPO exemption is met. SSA must accept the employer's statement at face value when making the determination that the GPO exemption is met.

Questions

1. How often should employees check their Social Security earnings record? Is there much of a chance that an error may occur?

SSA

Employees should check their Social Security earnings record at least once every three years. Errors in the earnings record are more likely to occur if the employee changes jobs frequently or has more than one employer. To check the earnings record, the employee should contact the local Social Security office or call SSA at 1-800-772-1213 (toll-free), and ask for Form 7004 (Request for Personal Earnings and Benefit Estimate Statement).

2. Are benefits figured on the last five years of earnings?

SSA

No. Retirement benefits are calculated on earnings during a lifetime of work under the Social Security system. Years of high earnings will increase the amount of the benefit.

3. Will my retirement pension from my job reduce the amount of my Social Security benefit?

SSA

If your pension is from work where you also paid Social Security taxes, it will not affect your Social Security benefit. Pensions from work that are not covered by Social Security (for example, the Federal civil service and some State or local government systems) probably will reduce the amount of your Social Security benefit. For additional information, see SSA publications "Government Pension Offset" (05-10007) and "A Pension for Work Not Covered" (05-10045).

4. 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?

SSA

Your benefits are reduced five-ninths of one percent for each month you are retired before age 65, up to a maximum of 20 percent for people who retire the month they reach 62. But remember, by taking benefits at age 62, you'll receive Social Security checks for a longer period of time.

5. 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?

SSA

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.

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Publications, Forms and Other Resources

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Publications and Forms — Internal Revenue Service

NOTES

Actual exhibits are not included in this section due to the fact that forms often change yearly. A more comprehensive list of IRS publications is available in IRS Publication 17 (Your Federal Income Tax).

Publication Number	Title
1	Your Rights as a Taxpayer
15	Circular E, Employer's Tax Guide
15-A	Employer's Supplemental Tax Guide
17	Your Federal Income Tax
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	Educational Expenses
509	Tax Calendars
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
553	Highlights of Tax Changes
571	Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations
575	Pension and Annuity Income
590	Individual Retirement Arrangements—IRAs

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Publication Number	Title
594	Understanding the Collection Process
596	Earned Income Credit
721	Tax Guide to U.S. Civil Service Retirement Benefits
901	U.S. Tax Treaties
910	Guide to Free Tax Services
915	Social Security and Equivalent Railroad Retirement Benefits
926	Household Employer's Tax Guide
939	Pension General Rule (Nonsimplified Method)
947	Practice Before the IRS and Power of Attorney
957	Reporting Back Pay and Special Wage Payments to the Social Security Administration
1542	Per Diem Rates
1976	Independent Contractor or Employee?

Form Number	Title
SS-4	Application For Employer Identification Number
SS-8	Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding
W-2	Wage And Tax Statement
W-2c	Statement of Corrected Income and Tax Amounts
W-3	Transmittal Of Wage and Tax Statements
W-3c	Transmittal of Corrected Income and Tax Statements
W-4	Employees Withholding Allowance Certificate
W-5	Earned Income Credit Advance Payment Certificate
W-8	Certificate Of Foreign Status
W-9	Request For Taxpayer Identification Number And Certificate
941	Employers Quarterly Federal Tax Return
941c	Supporting Statement To Correct Information

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Form Number	Title
943	Employer's Annual Tax Return For Agricultural Employees
945	Annual Return Of Withheld Federal Income Tax
945A	Annual Record of Federal Tax Liability
1001	Ownership, Exemption or Reduced Rate Certificate
1042	Annual Withholding Tax Return for U.S. Source Income of Foreign Persons
1042-S	Foreign Person's U.S. Source Income Subject to Withholding
1096	Annual Summary and Transmittal Of U.S. Information Returns
1099-MISC	Miscellaneous Income
8233	Exemption from Withholding on Compensation for Independent Personal Services of a Nonresident Alien Individual

To request IRS publications, telephone 1-800-829-3676 (toll-free). To request forms by fax, call 1-703-487-4160 from a telephone connected to a fax machine.

The IRS offers the following free of charge:

- Forms and instructions
- Publications
- IRS press releases and fact sheets
- TeleTax topics on about 150 tax topics
- Educational Materials

IRS can be accessed through the:

- Internet Web Site at http://www.irs.ustreas.gov
- Telnet at iris.irs.ustreas.gov
- File Transfer Protocol at ftp.irs.ustreas.gov
- or direct dial (by modem) by calling 1-703-321-8020.

NOTES

Publications and Forms — Social Security Administration

The following publications are available to assist employers in filing Form W-2 reports with SSA.

Publication Number	Title
16-004	Employer's Guide to Filing Timely and Accurate W-2 Wage Reports
31-011	Software Specification and Edits for Annual Wage Reporting
31-031	Software Specifications and Edits for Correcting Annual Wage Reports
42-007 (TIB-4)	Magnetic Media Reporting
—-	*Critical Links: Names and Social Security Numbers* (Shows correct format to enter names and Social Security numbers on the Form W-2 to ensure correct posting of earnings.
—-	*Verification of Names and Social Security Numbers* (Contains instructions for using SSA's Enumeration Verification System (EVS) to match names and Social Security numbers with SSA's records.)
—-	*SSA/IRS Reporter* (A newsletter that keeps employers informed of the latest wage and tax reporting news. It's free and mailed quarterly with the IRS' Form 941 (Employer Quarterly Federal Tax Return). To obtain a copy, call IRS toll-free at 1-800-829-FORM.

Publication Number	Title
SS-5	Application for Social Security Number
SSA-7004	Request for Earnings and Benefit Estimate Statement

To request SSA publications:

- telephone 1-800-772-1213 (toll-free), or

download via your computer and modem from the:

- SSA bulletin board at 410-965-1133, or
- Internet at http://www.ssa.gov.

Other SSA Services

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Employer Information Bulletin Board System (EIBBS)

Employers who have a PC and modem can access SSA's Employers Information Bulletin Board Service (EIBBS). The bulletin board contains recent editions of SSA's publications, schedules of SSA/IRS training seminars, answers to wage reporting questions, etc. The EIBBS can be accessed 24 hours a day, 7 days a week by dialing through the modem 1-410-965-1133.

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.

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.html. 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.

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Glossary

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Glossary of Terms

Absolute Coverage Group A permanent grouping of employees, e.g., all the employees of a city or town. It is a group for coverage, reporting and termination purposes. When used for coverage purposes, the term also refers to groups of employees whose positions are not under a retirement system.

Adjustment Reports Forms used to correct omissions, previous under reportings or over reportings of employees' wages and certain other errors in wage reports.

Agreement Section 218 Agreement

Alternative Lookback Rule This rule allows the employer to determine an employee's eligibility status to participate in a retirement plan based on past work experience or reasonable expectations as to meeting eligibility requirements during the first year of employment.

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 Services of State and local government employees are excluded from Medicare taxes if the employee 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.

Contribution Prior to 1987, Social Security taxes were called "contributions." The term was used because the payments were made pursuant to "voluntary" agreements. The amount of contributions owed was equal to the employment tax liability of private employers under the *Federal Insurance Contributions Act* (FICA). Therefore, prior to 1987, the states were liable for contributions; after 1986, public employers are liable for FICA taxes.

Coverage Groups Once an agreement has been entered into with a State, employees of the State and its political subdivisions are brought under the agreement in groups known as "coverage groups." There are two basic types of coverage groups:

1. Groups composed of employees of the State or one of its political subdivisions whose positions are not under a State or local retirement system (absolute coverage groups); and
2. Retirement system coverage groups which are composed of employees whose positions are covered by a State or local 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) 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 is an independent agency and continues to administer Social Security and Medicare benefits.

Defined Benefit Plan A plan that determines in advance the benefits to be received on retirement. Such plans are generally financed by annual contributions to pension funds that are determined by a number of variables, including the projected rate of return on investments.

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 and losses, and any forfeitures of accounts of other participants that may be allocated to the participant's account.

Divided Retirement System The provision of law that allows a retirement system to include the positions of members who elect coverage and positions of members who do not elect coverage. This is accomplished by the referendum process.

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.

EIC Earned income credit

EIN Employer identification number

Employee The term "employee" for purposes of a Federal-State Agreement, and for mandatory Medicare/mandatory Social Security purposes, means an employee as defined in Section 210(j) and 218(b) (3) of the *Social Security Act.* It includes an officer of a State or political subdivision. In most instances the common-law control test is applied in determining whether an employer-employee relationship exists.

Entity An entity is a political unit of a State, including the State itself and its political subdivisions.

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) The combined taxes of Social Security and Medicare imposed on employers and employees with respect to wages for employment.

Federal-State Agreement In January 1951 states allowed to provide Social Security coverage to employees of a State or State political subdivision by means of an agreement between the Federal government and the State. This agreement is governed by Section 218 of the *Social Security Act.*

Federal Unemployment Tax Act (FUTA) Unemployment Insurance (UI) tax imposed on employers to aid workers who lose their job through no fault of their own. State and political subdivisions within a State are exempt from paying FUTA, but most State and local government employees must be covered for State unemployment insurance purposes.

Fees When a public official receives remuneration for services in the form of a fee directly from the public, and all or part of the fee is retained by the official, that is considered to be a fee for Social Security coverage and taxation purposes. Conversely, when a public official receives payment for services from government funds and no portion of the monies collected from the public belongs to or can be retained by her/him as compensation, that is not considered to be a fee.

FICA *Federal Insurance Contributions Act*

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 The traditional functions of government, legislative, executive, judicial, e.g., the control and prevention of crime, acting for the general welfare, and providing for public safety.

Government Pension Offset The government pension offset applies only to people who get a non-covered 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.

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 The nine digit number assigned to a State or to a political subdivision of a State by the Social Security Administration to be used in correspondence regarding Section 218 Agreements, modifications and coverage matters.

Identifying Numbers This includes the identification number and any additional number or numbers added to the nine digit identification number to identify a coverage group or payroll record unit of a State or a political subdivision. There are also special unit numbers where limitation of liability is involved.

Ineligibles This term is used to refer to those individuals in positions covered by a retirement system who, for some personal reason such as age or length of service, are excluded from membership in the system.

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 Rulings/Determinations Method for obtaining a ruling from the IRS on a variety of issues including employee vs. independent contractor, wages and taxation issues. By law, there may be a fee for certain rulings. (Contact the IRS for further information.)

Mandatory Exclusions Those services which under Federal (*Social Security Act*) law may not be covered under a Section 218 Agreement.

Mandatory Medicare Public Law 99-272 extended mandatory Medicare Hospital Insurance coverage to all State and local employees, with certain exceptions, hired or rehired after March 31, 1986.

Mandatory Social Security Public Law 101-508 extended full Social Security coverage to all State and local employees, with certain exceptions, who are not members of their employer's retirement system effective July 2, 1991.

Medicare Qualified Government Employment (MQGE) State and local government employees whose services are not covered for Social Security but are required to pay Medicare tax only.

Modification A contract between the State and the Commissioner of Social Security (Prior to March 31, 1995, the agreements were between the State and the Secretary of Health and Human Services) that amends the original agreement to cover the services of employees previously excluded, or to modify the original agreement in some other respect.

MQGE Medicare Qualified Government Employment

NCSSSA National Conference of State Social Security Administrators

Noncovered Employment Employment not covered under Social Security.

OASDI Old-Age, Survivors and Disability Insurance Programs

Old-Age, Survivors and Disability Insurance Program (OASDI) Administered by the Social Security Administration which is responsible for providing monthly benefits to retired and disabled workers, their spouses and children, and to survivors of insured workers.

Optional Exclusions Those services the Federal law gives the State the option to include or exclude from coverage under the agreement.

Parallel Social Security Office (PSSO) The SSA office responsible for day-to-day negotiations with the States on State and local coverage issues.

PEBES Personal Earnings and Benefit Estimate Statement.

Pension Plans A pension plan is 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 measured by such factors as years of the employee's service and compensation received. Determination of the amount of retirement benefits and the contributions by the employer to provide benefits are not dependent on profits.

Personal Earnings and Benefit Estimate Statement (PEBES) This statement provides workers with information about their individual Social Security records, showing them the earnings that have been reported for them over the years and estimates of the different types of benefits for which they may qualify.

Political Subdivision A political subdivision for purposes of a Section 218 Agreement includes an instrumentality of a State, one or more of its political subdivisions, or a State and one or more of its political subdivisions. It is a separate legal entity of a State which usually has specific governmental functions. A political subdivision ordinarily includes a county, city, town, village, school district and other similar governmental entities. (Contact the State Social Security Administrator to determine an entity's coverage status for Section 218 purposes.)

Proprietary Function Functions of a governmental entity other than governmental in nature.

PSSO Parallel Social Security Office

Qualified Public Retirement System Refers to a retirement system of a State, political subdivision or instrumentality thereof that meets the qualification tests under section 3121(b)(7)(F) of the Internal Revenue Code.

Retirement System For purposes of Section 218 of the *Social Security Act*, a pension, annuity, retirement, or similar fund or system established by a State or political subdivision. Ordinarily, if a State or political subdivision participates in the cost of an annuity plan and/ or if the plan was established under the authority of the State or political subdivision, the plan is a retirement system.

SECA *Self Employment Contributions Act*

Section 218 Agreement Voluntary agreements between the State and the Commissioner of Social Security. (Prior to March 31, 1995, the agreements were between the State and the Secretary of Health and Human Services). These agreements allow the states, if they so desire, to provide Social Security coverage for the services of State and local government employees. The agreements cover positions, not individuals, and if the position is covered under the agreement, then any employee filling that position is subject to FICA taxes.

Self Employment Contributions Act (SECA) Generally, the Social Security and Medicare taxes imposed on self-employed individuals.

SIC Standard Industrial Classification.

Social Security Act (Act) Provides for Federal old-age, survivors, disability and hospital insurance, Federal-State public assistance and unemployment compensation, and extension of public health services, maternal and child health services, services for crippled children, child welfare services and vocational rehabilitation services. Some of these programs are administered at the Federal level; some are administered at the State level.

Social Security Administration (SSA) An independent agency in the executive branch of the Federal government responsible for administering the old-age, survivors and disability insurance program and for determining eligibility for Medicare benefits.

Standard Industrial Classification (SIC) Each business, including public employers, is assigned a 4-digit SIC code that describes the nature of the business in accordance with the *Standard Industrial Classification Manual, 1987.*

State Social Security Administrator The principle State official authorized by State law to administer the Section 218 Agreement with the Social Security Administration and for all other activities associated with applicable Federal and State laws addressing Social Security/Medicare by State and local public employers in the State.

Social Security Number (SSN) The 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 which administer the Social Security program locally. These servicing offices may request technical assistance from the PSSO as needed.

SSA Social Security Administration.

State The term "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 The number used to identify employee (SSN) or employer (EIN) for tax reporting purposes.

TIN Taxpayer identification number.

Wage Base The wage base is the maximum wage that is subject to the tax for the year. The Social Security wage base changes yearly. There is no wage base limit for Medicare beginning in 1994.

Wages Remuneration (with certain exceptions) for services of an employee covered under an agreement or as a result of the mandatory Medicare or mandatory Social Security provisions of the *Social Security Act*.

Wholly Owned Instrumentality An instrumentality organized to carry on some function of government for 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.

Windfall Elimination Provision The windfall elimination formula in noncovered employment, i.e., employment not covered under Social Security produces a lower Social Security retirement or disability insurance benefit. This provision primarily affects people who spent most of their careers working for a government agency, but who also worked at other jobs where they paid Social Security taxes long enough to qualify for retirement or disability benefits.

Appendix

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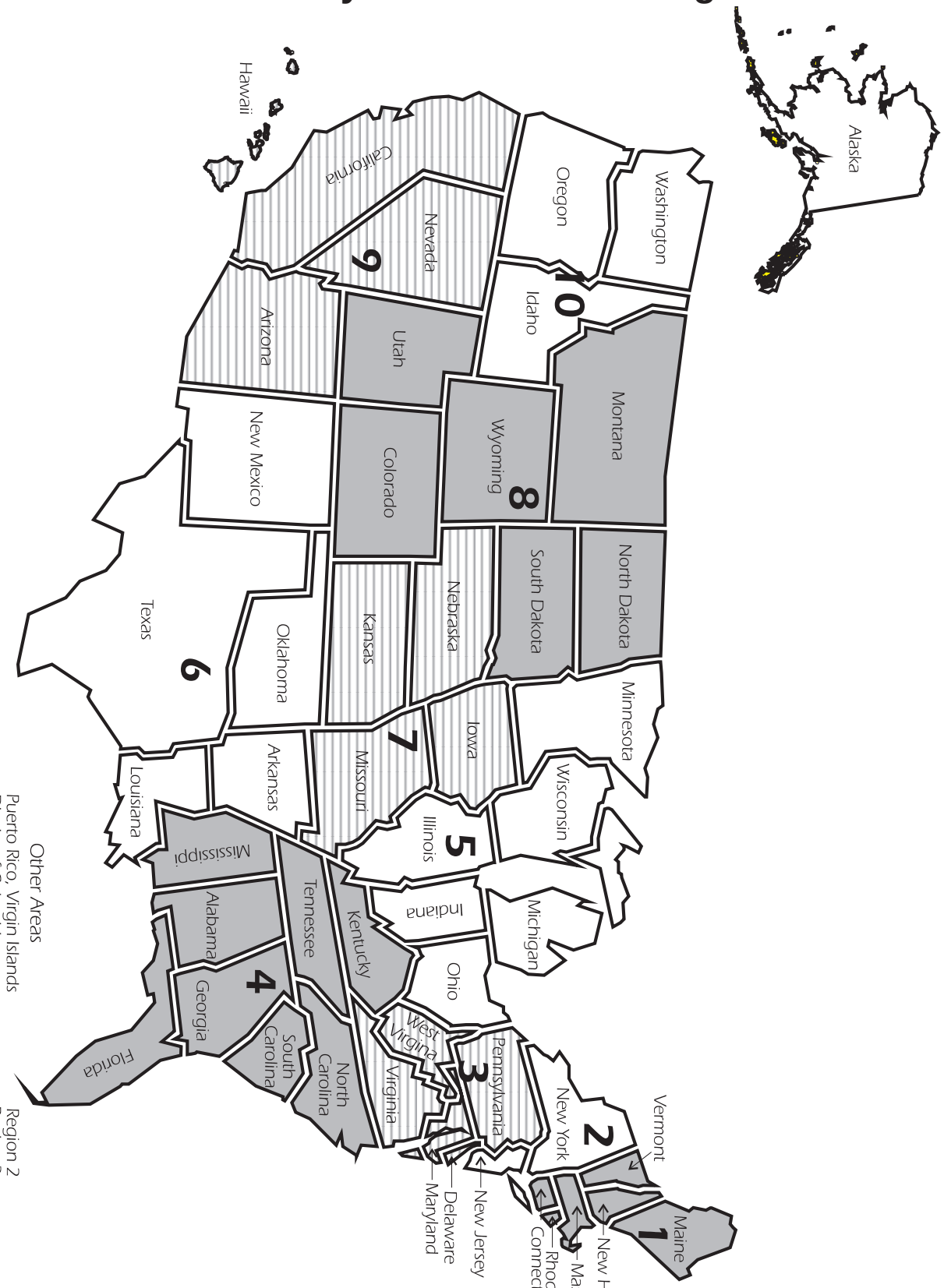
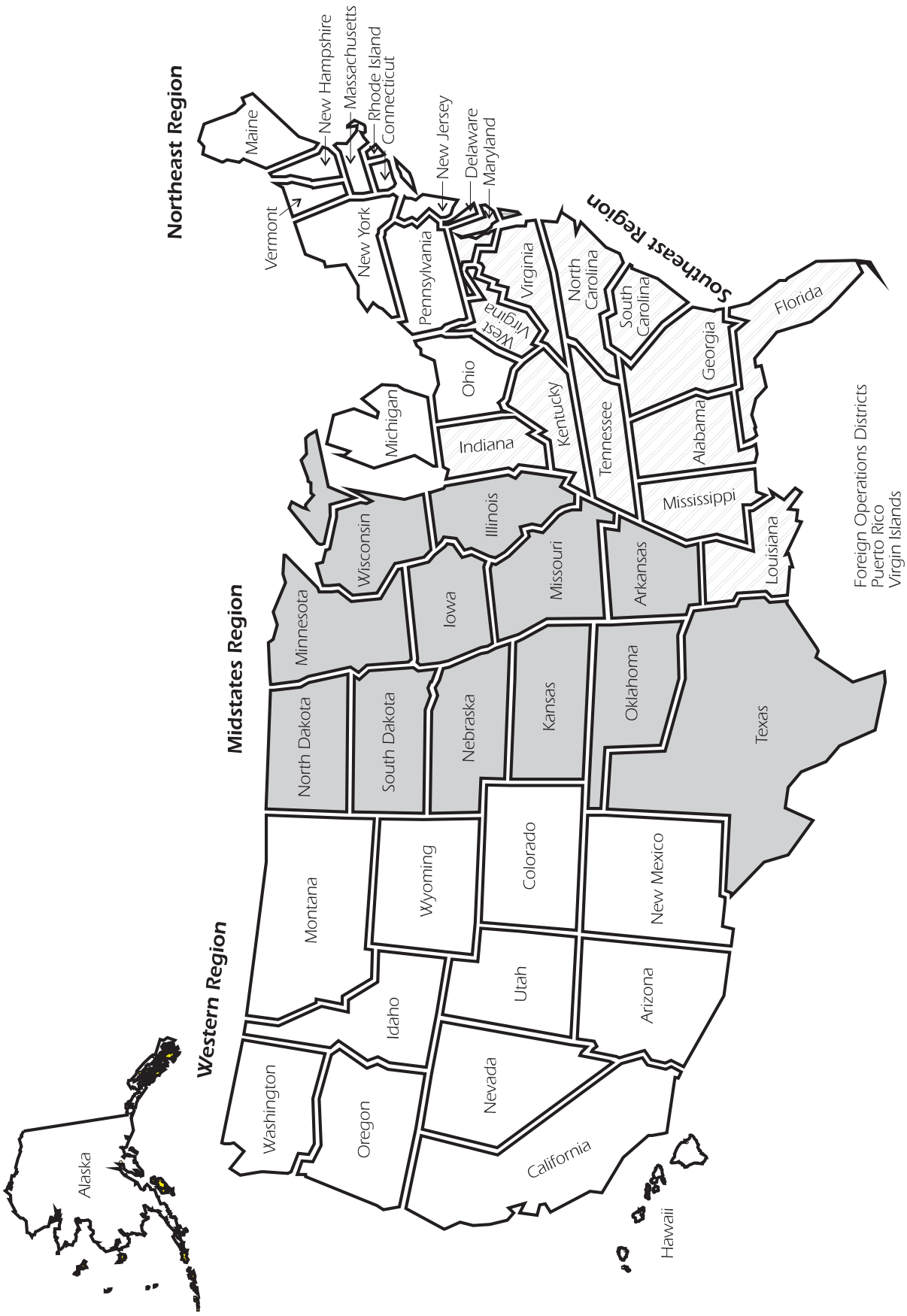
Social Security Administration Regions



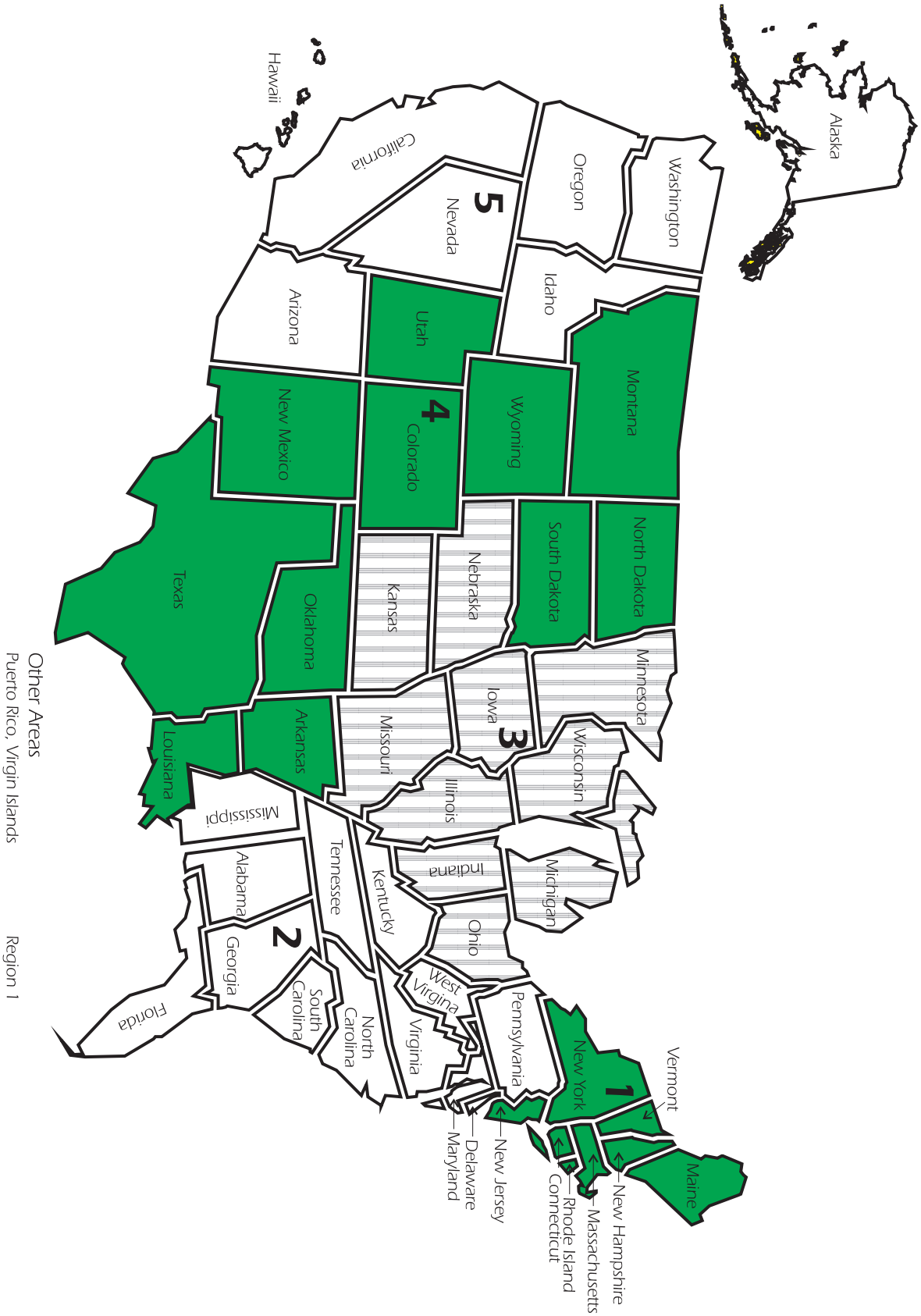
Note: SSA office locations are being reexamined and may be reorganized.

Other Areas
Puerto Rico, Virgin Islands — Region 2
District of Columbia — Region 3
American Samoa, Guam, Trust Territory of the Pacific Islands — Region 9

Internal Revenue Service Regions

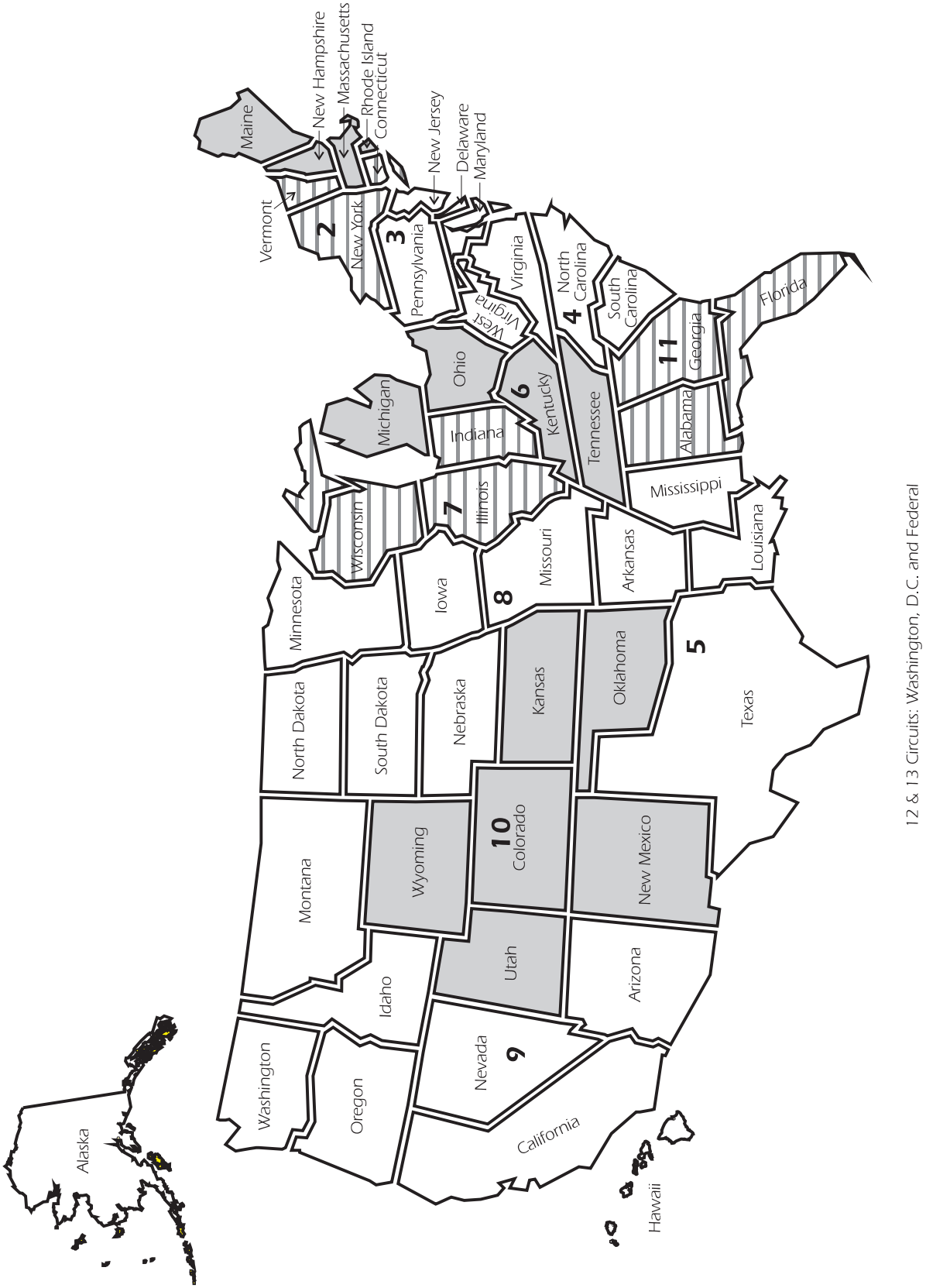


National Conference Of State Social Security Administrators (NCSSSA) Regions



United States Circuit Courts

Rulings in the United States Circuit Court apply only to the states within their respective circuit and only apply nationwide if upheld by the Untied States Supreme Court.



Internal Revenue Service District Offices

The IRS, in an effort to streamline management including support of field operations, has undergone a reorganization. The plan reduced the seven regional offices to four and is in the process of reducing the 63 district offices to 33. Listed below are the 63 designated district offices before the transition was complete.The list also includes addresses for Puerto Rico and the Virgin Islands.

Direct inquiries to: District Director (or District Director Representative), Internal Revenue Service

Alabama
500 22nd Street S.
Birmingham, AL 35233

Alaska
949 E. 36th Avenue
Anchorage, AK 99508

Arizona
210 E. Earll Drive
Phoenix, AZ 85012

Arkansas
700 W. Capitol Avenue
Little Rock, AR 72201

California

24000 Avila Road
Laguna Niguel, CA 92677

300 N. Los Angeles Street
Los Angeles, CA 90012

1301 Clay Street
Suite 1600 S
Oakland, CA 94612

450 Golden Gate Avenue
San Francisco, CA 94102

55 S. Market Street
San Jose, CA 95113

Colorado
600 17th Street
Denver, CO 80202

Connecticut
135 High Street
Hartford, CT 06103

Delaware
844 King Street
Wilmington, DE 19801

District of Columbia
See Maryland

Florida

1 University Dr., 3rd Fl,
Bldg B
Ft. Lauderdale, FL 33324

400 W. Bay Street
Jacksonville, FL 32202

Georgia
401 W. Peachtree Street
Atlanta, GA 30365

Hawaii
300 Ala Moana Boulevard
Honolulu, HI 96850

Idaho
550 W. Fort Street
Boise, ID 83724

Illinois

230 S. Dearborn Street
Chicago, IL 60604

320 W. Washington Street
Springfield, IL 62701

Indiana
575 N. Pennsylvania
Indianapolis, IN 46204

Iowa
210 Walnut Street
Des Moines, IA 50309

Kansas
412 S. Main
Wichita, KS 67202

Kentucky
601 W. Broadway
Louisville, KY 40202

Louisiana
600 S. Maestri Place
Stop 6
New Orleans, LA 70130

Maine
68 Sewall Street
Augusta, ME 04330

Maryland
31 Hopkins Plaza
Baltimore, MD 21201

Massachusetts
John F. Kennedy Federal Bldg.
Boston, MA 02203

Michigan
477 Michigan Avenue
Detroit, MI 48226

Minnesota
316 N. Robert Street
St. Paul, MN 55101

Mississippi
100 W. Capitol Street
Jackson, MS 39269

Missouri
1222 Spruce St., Rm 2300
Mail Code 1000 STL
St. Louis, MO 63103

Montana
301 S. Park Avenue
Helena, MT 59626

Internal Revenue Service Districts Continued

Nebraska
106 S. 15th Street
Omaha, NE 68102

Nevada
4750 W. Oakey Boulevard
Las Vegas, NV 89102

New Hampshire
80 Daniel Street
Portsmouth, NH 03801

New Jersey
970 Broad Street
Newark, NJ 07102

New Mexico
517 Gold Avenue, SW
Albuquerque, NM 87102

New York

Clinton Ave. & North Pearl St.
Albany, NY 12207

10 Metro Tech Center
625 Fulton St.
Brooklyn, NY 11201

11 W. Huron Street
Buffalo, NY 14202

Manhattan
290 Broadway
New York, NY 10007

North Carolina
320 Federal Place
Greensboro, NC 27401

North Dakota
653 2nd Avenue, N.
Fargo, ND 58102

Ohio

550 Main Street
Cincinnati, OH 45202

1240 E. 9th Street
Cleveland, OH 44199

Oklahoma
55 N. Robinson St.
Mail Code 1000 OKC
Oklahoma City, OK 73102

Oregon
1220 SW 3rd Street
Portland, OR 97204

Pennsylvania

600 Arch Street
Philadelphia, PA 19106

1000 Liberty Avenue
Pittsburgh, PA 15222

Puerto Rico
Mercantile Plaza Bldg.
2 Ponce de Leon Ave.
San Juan, PR 00918

Rhode Island
380 Westminster Mall
Providence, RI 02903

South Carolina
1835 Assembly Street
Columbia, SC 29201

South Dakota
115 4th Avenue, SE
Aberdeen, SD 57401

Tennessee
801 Broadway
Nashville, TN 37203

Texas

300 E. 8th Street
Austin, TX 78701

Texas continued
1919 Smith Street
Houston, TX 77002

1100 Commerce Street
Dallas, TX 75242

Utah
465 S. 4th Street East
Salt Lake City, UT 84111

Vermont
199 Main Street
Burlington, VT 05402

Virgin Islands
9601 Estate Thomas
Charlotte Amalie, VI 00802

Virginia
400 N. 8th Street
Richmond, VA 23240

Washington
915 2nd Avenue
Seattle, WA 98174

West Virginia
425 Juliana Street
Parkersburg, WV 26101

Wisconsin
310 W. Wisconsin Avenue
Milwaukee, WI 53203

Wyoming
308 W. 21st Street
Cheyenne, WY 82001

International
Assistant Commissioner
(International)
4401 L'Enfant Plaza
Washington, DC 20224

Section 218 Voluntary Agreements for Coverage of State and Local Employees [42 U.S.C. 418]

(a) Purpose of agreement.

(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 [42 USCS §§401 et seq.] 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) [42 USCS §410(a)], for the purposes of this title [42 USCS §§401 et seq.] the term "employment" includes any service included under an agreement entered into under this section.

(b) Definitions.

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 [32 USCS §709 note] 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 [42 USCS §§301 et seq.], 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.

(c) Services covered.

(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) [42 USCS §410(a)] other than paragraph (7) of such section [42 USCS §410(a)(7)] and service the remuneration for which is excluded from wages by subparagraph (B) of section 209(a)(7) [42 USCS §409(a)(7)(B)].

(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) [42 USCS §410(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) [42 USCS §410(a)] other than paragraph (7) of such section [42 USCS §410(a)(7)],

(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) [42 USCS §410(a)(7)(F)] which is included as "employment" under section 210(a) [42 USCS §410(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) [42 USCS §415(a)(1)(B)(ii)] with respect to the amounts referred to in section 215(a)(1)(B)(i) [42 USCS §415(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) [42 USCS §415(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.

(d) Positions covered by retirement systems.

(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 [enacted Sept. 1, 1954] (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 [enacted Sept. 1, 1954], 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 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 [42 USCS §§401 et seq.] 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 [42 USCS §§401 et seq.] 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 [enacted Aug. 1, 1956], 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 [42 USCS §401 et seq.].

(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 [42 USCS §§401 et seq.].

(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 paragraph (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 [42 USCS §§501 et seq.], 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 (l) 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.

(e) Effective date of agreement.

(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 [26 USCS §§3101, 3111] had such services constituted employment for purposes of chapter 21 of such Code [26 USCS §§3101 et seq.] 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).

(f) Duration of agreement.

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 [enacted Apr. 20, 1983].

(g) Instrumentalities of two or more States.

(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 [enacted Aug. 30, 1957]) 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 the 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 [enacted Aug. 30, 1957] 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 [42 USCS §§401 et seq.]. 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 c overage under such agreement).

(3) Any agreement with any instrumentality of two or more States entered into pursuant to this Act [42 USCS §§301 et seq.] 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.

(h) Delegation of functions.

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 therefor shall be in advance or by way of reimbursement, as may be provided in such agreement.

(i) Wisconsin Retirement Fund.

(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 success or 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.

(j) Certain positions no longer covered by retirement systems.

Notwithstanding subsection (d), an agreement with any State entered into under this section prior to the date of the enactment of this subsection [enacted Sept. 1, 1954] 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 [enacted Sept. 1, 1954]), 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 [enacted Sept. 1, 1954], are no longer covered by a retirement system on the date such agreement is made applicable to such services.

(k) Certain employees of the State of Utah.

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.

(l) Policemen and firemen in certain States.

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 [enacted Aug. 1, 1956], 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.

(m) Positions compensated solely on a fee basis.

(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) Optional medicare coverage of current employees.

(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 [42 USCS §§1395 et seq.], and sections 226 and 226A [42 USCS §§426, 426-1], 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) [42 USCS §410(p)] by reason of paragraph (3) of such section [42 USCS §410(p)(3)]; 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 [42 USCS §§426, 426-1], 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.

Revenue Ruling 86-88

Section 13205 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (the Act), amended section 3121(u) of the Internal Revenue Code. In general, the amendment applies sections 3101(b) and 3111(b), the hospital insurance (medicare) tax portion of the Federal Insurance Contributions Act (FICA), to wages for services rendered after March 31, 1986, by newly hired employees of states and political subdivisions. Previously most employees of states and political subdivisions were not covered under the FICA, as their services were excepted from the term "employment" by section 3121 (b)(7).

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 SecurityAct, 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

Ql. What services are subject to the medicare tax under the Act?

Al. 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 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&A7 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)(1) 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, as 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)(1) 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 employee 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 if 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)(l)-(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&Al 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&Al and Q&A2 above.

Q10. A student is hired by school, college, or university after March 31, 1986, to perform services of 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 aftending 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?

Al1. No, not in all cases. The term "wages" for purposes of paying medicare tax is defined by section 312 1 (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

> *EDITOR'S NOTE: The following questions and answers have been modified by the enactment of PL 99-509 that changed the requirements governmental employers follow in depositing their FICA (social security and medicare) tax withholdings. Governmental employers, effective January 1, 1987, pay FICA taxes to the IRS rather than to the state.*

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 a political subdivision employer of that political subdivision was covered under a 218 agreement.

The medicare tax is reported and paid 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 the 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 employers share of the taxes. For those federal employees subject 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 O&Al2, 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 For 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 “941/941E” 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&Al2, 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” check box 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 box “941/941E” on the Form W-3.

Revenue Ruling 88-36

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

Ql. 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?

Al. 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.

> *EDITOR'S NOTE: The above section was amended in 1994 to increase the exclusion threshold for election workers and election officials from $100 to $1,000.*

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 instrumen-tality 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 if 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 compen-sation 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 compen-sation 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 require-ments 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(l). 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 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 PARTICPATE 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.