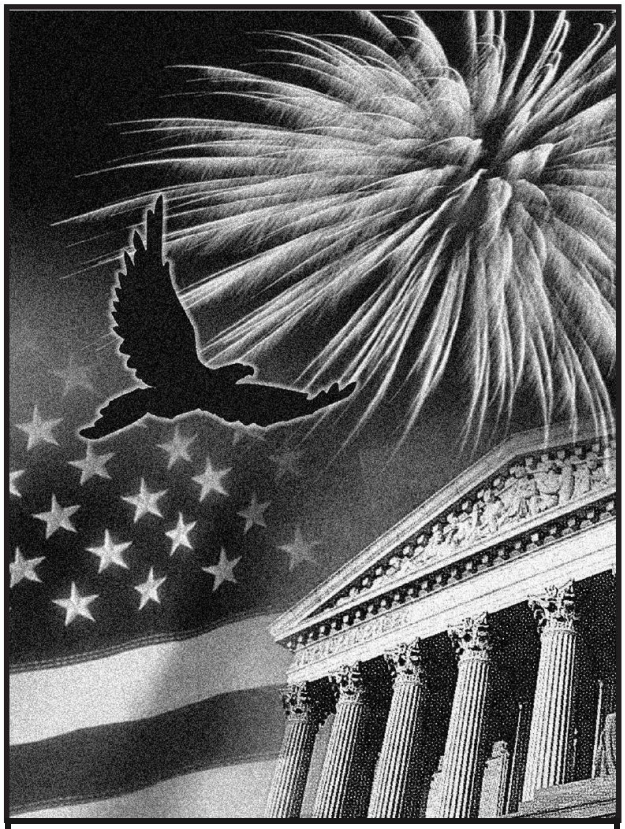
Publication 963

(Rev. July 2020)

Federal-State Reference Guide

Volume 5 of 6



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Publication 963 (Rev 07 2020) Catalog Number 59247D
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1. **How does an employee verify the information that SSA shows on their earnings record?**

Individuals can get their personal Social Security statement online by using their my Social Security account. SSA mails paper statements to workers age 60 and older three months before their birthday if they do not receive Social Security benefits and do not yet have a my Social Security account. [SSA]

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

SSA may provide interpretations of the Social Security Act, Social Security regulations, rulings, the state Section 218 Agreement and its, as they apply to a public employer. [SSA]

3. **Whom should I call when I have questions about annual wage reporting?** Call your local SSA ESLO. See Chapter 7. [SSA]

4. My employees are paying into the State Teachers' Retirement System and some have enough Social Security credits from former employment to be eligible for Social Security benefits. Will they receive benefits from both?

Yes, but the Windfall Elimination Provision may reduce Social Security benefits. Additionally, spouses' benefits may be reduced by the Government Pension Offset formula. See Chapter 6. [SSA]

Chapter 8

Internal Revenue Service

The Internal Revenue Service (IRS), an agency of the U.S. Department of Treasury, is charged with the administration of the tax laws passed by Congress. This includes assisting taxpayers with education, account issues and filing

responsibilities, as well as conducting compliance and enforcement activities.

More information about the programs and responsibilities of the IRS is available at IRS.gov. Information for federal, state and local governments, including employment tax, is available at IRS.gov/FSLG.

Organization

National headquarters for the IRS, in Washington, DC, develops nationwide policies and programs for the administration of the agency. The chief executive of the agency is

the IRS Commissioner. Several functions report directly to the Commissioner, including:

- Chief Counsel
- Appeals
- Taxpayer Advocate Service
- Communications & Liaison
- Research, Applied Analytics, and Statistics
- Equity, Diversity and Inclusion

The IRS is organized around four specific "customer bases" or groups of taxpayers with generally common interests and needs. Each operating division has a Commissioner and its own Counsel to provide legal expertise and guidance.

The four customer-based divisions are:

Wage and Investment (W&I) is focused on individual taxpayers and income tax returns.

Small Business/Self-Employed (SB/SE) is oriented to S corporations, partnerships, small corporations and sole proprietors.

Large Business and International (LB&I) deals with large businesses and international tax issues.

Tax Exempt and Government Entities (TE/GE) serves all government organizations as well as nonprofit and other exempt organizations. Most or all of the contact with the IRS that a government entity has will be with TE/GE, so it is discussed in more detail below. TE/GE has responsibility for providing assistance and education to taxpayers, as well as performing compliance activities related to these organizations.

Tax Exempt and Government Entities Division

The Tax Exempt and Government Entities Division was established in 1999 and replaced

the former office of Assistant Commissioner (Employee Plans and Exempt Organizations).

TE/GE customers range from small local community organizations and municipalities to major universities, large pension funds, state governments, federal agencies, Indian tribal governments and issuers of tax-exempt bonds. These organizations represent a large economic sector with unique needs. They are governed by often complex, highly specialized provisions of the tax law.

TE/GE serves three distinct customer segments:

- Employee Plans
  - Retirement plans, IRAs and related trusts
  - Plan participants and beneficiaries
  - Employer sponsors of retirement plans

- Exempt Organizations
  - Organizations exempt from income tax under IRC Section 501 (including charities, private foundations and other types of exempt organizations, such as business leagues, labor unions and veterans' organizations) » Political organizations described in IRC 527
- Government Entities
  - Federal, State and Local Governments
  - Indian Tribal Governments
  - Tax Exempt Bonds

Federal, State and Local Governments/Employment Tax (FSL/ET), formerly known as FSLG, is responsible for administering the tax laws affecting federal, state and local government entities. Its primary focus is ensuring compliance on information return reporting and employment tax issues for government entities. It provides easily accessible and equitable voluntary

compliance programs for its government customers.

Indian Tribal Governments helps Indian tribes deal with their federal tax matters and provides a single point of contact for assistance and service. The ITG specialists address issues and provide guidance to Indian tribes, whose concerns may relate to tribal governments as employers, distributions to tribal members and the establishment of governmental programs, trusts and businesses. Visit IRS.gov/tribes to find the ITG specialist assigned to your tribe and links to other information.

Tax Exempt Bonds provides information to the tax-exempt bond community and encourages voluntary compliance through educational resources, Voluntary Closing Agreement Program and interactive forms. For more information, visit IRS.gov/bonds.

Customer Account Services

If you are authorized to represent a taxpayer, you can call 877-829-5500 toll-free for your government entities questions on:

- Your account
- General information about tax exemption of a government
- Private letter ruling requests

Note: Although the State Administrator is responsible for maintaining and interpreting your Section 218 Agreement, federal disclosure laws prohibit the State Administrator from inspecting your tax information without your consent. If you would like the State Administrator to assist you with a Section 218 Agreement or related Social Security coverage issue, you can expedite the process by completing Form 8821, Tax Information Authorization, and filing it with the IRS.

Publications and Forms — Internal Revenue Service

You can download most IRS forms and publications at IRS.gov/forms or order them online or by mail at IRS.gov/orderforms.

Publication/ Form Number	Title
1	Your Rights as a Taxpayer
15	(Circular E), Employer's Tax Guide
15-A	Employer's Supplemental Tax Guide
15-B	Employer's Tax Guide to Fringe Benefits
80	(Circular SS), Federal Tax Guide for Employers in the U.S. Virgin Islands, Guam,

	American Samoa, and the Commonwealth of the Northern Mariana Islands
463	Travel, Gift, and Car Expenses
515	Withholding of Tax on Nonresident Aliens and Foreign Entities
571	Tax-Sheltered Annuity Plans (403(b) Plans)
594	The IRS Collection Process
947	Practice Before the IRS and Power of Attorney
957	Reporting Back Pay and Special Wage Payments to the Social Security Administration

1141	General Rules and Specifications for Substitute Forms W-2 and W-3
1179	General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498, and Certain Other Information Returns
1976	Do You Qualify for Relief Under Section 530?
2108A	On-Line Taxpayer Identification Number (TIN) Matching Program
4268	Employment Tax for Indian Tribal Governments
5137	Fringe Benefit Guide
SS-4	Application for Employer Identification Number

SS-8	Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding
W-2	Wage and Tax Statement
W-2c	Corrected Wage and Tax Statement
W-3	Transmittal of Wage and Tax Statements
W-3c	Transmittal of Corrected Wage and Tax Statements
W-4	Employee's Withholding Certificate
W-9	Request for Taxpayer Identification Number and Certification
941	Employer's Quarterly Federal Tax Return

Publication/ Form Number	Title
941-X	Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund
943	Employer's Annual Tax Return for Agricultural Employees
944	Employer's Annual Federal Tax Return
944-X	Adjusted Employer's Annual Federal Tax Return or Claim for Refund
945	Annual Return of Withheld Federal Income Tax
945-A	Annual Record of Federal Tax Liability

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
2848	Power of Attorney and Declaration of Representative
8233	Exemption From Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual

8821	Tax Information Authorization
14581-A	Fringe Benefits Compliance Self-Assessment For Public Employers
14581-B	International Issues Compliance Self-Assessment For Public Employers
14581-C	Medicare Coverage Compliance Self-Assessment For State and Local Government Employers
14581-D	Other Tax Issues Compliance Self-Assessment For Public Employers
14581-E	Retirement Plan Coverage Compliance Self-Assessment For State and Local Government Entities

14581-F	Social Security Coverage Compliance Self-Assessment For State and Local Government Entities
14581-G	Employee or Independent Contractor Compliance Self-Assessment For Public Employers

Frequently Asked Questions

1. What information can IRS provide to a governmental unit about its Social Security coverage and tax liability?

The IRS is responsible for assessing and collecting all taxes and interpreting and applying the tax law. By contacting Customer Account Services, an authorized person can receive tax information about an entity. Questions about Section 218 Agreement coverage should be directed to your State Social Security Administrator.

2. 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 their state?

IRC Section 6103 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 authorizes the IRS to share specific taxpayer information with State Social Security Administrators. However, in performing a tax investigation, the IRS may request information from the State Social Security Administrator. State administrators are encouraged to share information, consistent with state law, with the IRS to help resolve matters of mutual interest. Your State Social Security Administrator can better assist you if you consent to make your federal tax information available for the Administrator's

review. A government entity can grant a State Administrator access to its tax information by completing Form 8821, Tax Information Authorization.

3. Can I arrange for the State Social Security Administrator to receive my tax information or discuss it with the IRS?

If you have a Section 218 Agreement to provide Social Security coverage for your employees, you may wish to have the State Social Security Administrator consulted or otherwise involved in the examination. The State Administrator is not considered an official responsible for the administration of state or federal tax laws under Section 6103; therefore, there is no provision in the law allowing the IRS to disclose tax information in this situation. If you are reviewing an issue with the IRS involving Section 218 coverage, and you wish to have the State Administrator or a representative participate in the

discussion, you should complete either Form 2848, Power of Attorney and Declaration of Representative, or Form 8821, Tax Information Authorization, as appropriate. These forms are discussed at Disclosure Laws.

Chapter 9

State Social Security Administrators

SSA Regulation 20 CFR Section 404.1204 requires each state to designate at least one state official to act for them in administering that state's Section 218 Agreement. This official, the State Social Security Administrator, acts for the state with respect to its responsibilities for maintaining and administering the provisions of the agreement as well as the proper application of Social Security and Medicare.

The designated State Social Security Administrator (State Administrator) acts for the state in negotiations with the SSA. This includes acting for the state with respect to the initial Section 218 Agreement and 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 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 its designated state official. That official should send a notification to the SSA Regional and Parallel Social Security offices for that state.

The extent of the State Administrators' responsibilities vary from state to state. The location of State Social Security Administrators’ offices and the extent and scope of their responsibilities are determined by each state. Details on each state are contained in the respective state’s enabling legislation, citations for which are listed in the Appendix. Frequently, a State Administrator has other responsibilities, including those related to non-218 entities. A detailed list of

basic State Administrator responsibilities is available at Program Operations Manual System (POMS). Also see SSA.gov/SLGE.

For Section 218 Agreement purposes, the State Administrator:

- Administers and maintains the federal-state Section 218 Agreement that governs voluntary Social Security and Medicare coverage by state and local government employers in the state;
- Negotiates modifications to the original agreement to include additional coverage groups, corrects errors in modifications, conducts referendums and identifies additional political subdivisions that join a covered retirement system;
- Maintains in a secured location the state's master agreements, modifications, dissolutions and intrastate agreements;

- Provides SSA with notice and evidence of the legal dissolution of covered state or political subdivision entities;
- Resolves coverage and taxation questions related to the agreement and modifications with SSA and IRS;
- Negotiates with SSA to resolve Social Security contribution payment and wage reporting questions concerning wages paid before 1987;
- Informs SSA of name, title and address of designated officials involved in Section 218 administration and notifies SSA of any changes;
- Informs SSA of any changes in a government entity's legal status, such as name changes, dissolutions or consolidations;
- Communicates regularly with SSA, IRS, employers and stakeholders on Section 218-related issues;

- Provides information to state and local public employers covered under agreements in accordance with the Act; and
- Determines necessary funding and staffing for administration of the Section 218 program.

Note: IRC Section 6103 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 authorizes the IRS to share specific taxpayer information with State Social Security Administrators. However, in performing a tax investigation, the IRS may request information from the State Social Security Administrator.

The State Administrator is the principal state official responsible for these functions. The Administrator serves as the main resource to state and local employers for information and advice about Social Security coverage,

taxation and many reporting issues. SSA, IRS, public employers and employees should contact the designated Administrator to help resolve coverage questions concerning groups or individual employees. Public employers should advise the State Social Security Administrator of any changes in a government entity's legal status, such as name changes, dissolutions or consolidations. More detailed information is available at the SSA POMS webpage.

By allowing the State Administrator to inspect your tax information, you can speed up resolving any coverage or federal tax issues with the IRS. A government entity may consent to have a State Administrator or representative review tax information by filing Form 8821, Tax Information Authorization, and filing it with the IRS.

National Conference of State Social Security Administrators (NCSSSA)

The ever-changing and complex Social Security coverage statutes, withholding requirements, reporting obligations and associated employment tax regulations require constant monitoring and interpretation. For more than 50 years the National Conference of State Social Security Administrators (NCSSSA.org) 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 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 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. As a result, the NCSSSA was established to provide a unified state perspective at the federal level to provide an on-going medium for problem-solving and to maintain an open forum for the development of new policy.

Since its formation in 1952, the NCSSSA has worked closely with SSA and IRS to address Social Security (and later Medicare) coverage and employment tax issues raised by state and local employers and State Social Security Administrators throughout the United States. The NCSSSA works with federal officials to

ensure that legislative and regulatory changes address state and local concerns. They provide leadership to state and local governments through accurate interpretation of federal laws and regulations, communication of federal tax policy and resolution of problems arising at the state and local level. The NCSSSA hosts national workshops and annual meetings where SSA and IRS officials address the concerns of state and local government representatives in a face-to-face format. NCSSSA officials represent public sector employers on various SSA and IRS committees and work groups.

Audits and Reviews of Public Employers

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

- Whether the employees are covered under a Section 218 Agreement; and, if so,

- The specific exclusions (required and optional) that apply to that entity that must be considered during the audit or review, including any that are unique to individual employees (for example, whether any employees are subject to the Medicare continuing employment exemption).

For further information about the NCSSSA, contact your State Social Security Administrator, or go to NCSSSA.org.

Glossary

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

Additional Medicare Tax – This tax on employees is imposed on the wages of certain employees under IRC Section 3101(b)(2) and is in addition to the Medicare tax under IRC Section 3101(b)(1). Employers must begin withholding the Additional Medicare Tax when an employee's Medicare wages exceed $200,000 during a calendar year.

Alternative Lookback Rule – An optional method for determining whether an employee can be treated as a qualified participant in a retirement plan for purposes of determining

whether mandatory Social Security applies. Under this rule, an employer may treat an employee as a qualified participant in the first year of employment if it is reasonable to believe the employee will be a qualified participant on the last day of the plan year. An employer may treat an employee as a qualified participant in a calendar year if the employee was a qualified participant at the end of the previous plan year. Treas. Reg. 31.3121(b)(7)-2(d)(3).

Continuing Employment Exception – Provision for exclusion of an employee from Medicare tax and coverage for services of a state or local government employee who is not covered by a Section 218 Agreement, is a participant in a public retirement system and meets all of the following requirements:

- The employee was performing regular and substantial services for remuneration for the employer before April 1, 1986;

- The employee was a bona fide employee on March 31, 1986;
- The employment relationship was not entered into for purposes of avoiding the Medicare tax; and
- The employment relationship with the employer has not been terminated after March 31, 1986.

Coverage Groups – Categories of state and local government employees with respect to a Section 218 Agreement. There are two types of coverage groups:

1. **Absolute coverage groups:** employees in positions not covered under a retirement system
2. **Retirement system coverage groups:** employees in positions covered by a retirement system

The Social Security Act gives each state the right, within the limits of state and federal laws, to decide which coverage groups are to

be included under its agreement and any modifications to the agreement.

Defined Benefit Plan – An employer plan that uses an actuary to determine retirement benefits under a formula, generally based on age, years of service and salary level.

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

Earnings Record – The information maintained by the SSA for an individual indicating Social Security and Medicare covered wages and self-employment income. Each individual's record is accessed by SSN.

Employee – Generally any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, is subject to the employment tax requirements of IRC Sections 3121 and 3401. The term is defined for Social Security and Medicare purposes in Sections 210(j) and 218(b)(3) of the Social Security Act and IRC Section 3121(d).

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

Entity – A separate legal "person," that is not an individual; includes a corporation, partnership, LLC or a political unit, including a

state, a political subdivision, a wholly-owned instrumentality, a municipality and so on.

Federal Insurance Contributions Act (FICA) – (IRC Sections 3101-3128) Federal statute providing for payroll tax deductions of Social Security and Medicare taxes from employees' wages (employee portion), for employer's obligation to deduct from wages and pay over the employee portion and for employer liability for the employer portion of Social Security and Medicare taxes on wages to fund Social Security and Medicare coverage.

Federal Unemployment Tax Act (FUTA) – Federal statute imposing tax on employers to provide for payments of unemployment compensation to workers who have lost their jobs. States and political subdivisions of a state are exempt from paying FUTA, but under state unemployment law, most state and local government employees must be covered for state unemployment insurance.

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

FICA Replacement Plan – Alternate name for a public retirement system, as described in the regulations for Section 3121(b)(7)(F) (See Treas. Reg. 31.3121(b)(7)-2). Refers to a pension, annuity, retirement or similar fund or system established by a state or political subdivision for the purpose of providing retirement benefits to employees. See Public Retirement System.

Full Retirement Age (FRA) – The age at which unreduced Social Security benefits are payable. Depending on the date of birth, an individual's FRA ranges from 65 to 67.

Governmental Function – Activity normally associated with the authority of government, legislative, executive, judicial, such as the control and prevention of crime, promoting the general welfare and providing for public safety. Income derived from any essential governmental function is exempt from federal income tax under IRC Section 115.

Government Pension Offset (GPO) – A reduction in the Social Security benefits that applies to individuals who (1) receive a government pension from work not covered for Social Security and (2) are eligible for Social Security as a spouse or widow(er).

Two-thirds of the government pension offsets any spouse's or widow(er)'s Social Security benefit.

HI – Hospital Insurance (Medicare Part A).

Indian Tribal Government – The governing body of any federally recognized tribe, band, community, village or group of Indians or

Alaska Natives that is determined by the Secretary of the Treasury, with the Secretary of the Interior, to exercise governmental functions under IRC Section 7701(a)(40). Under IRC Section 7871, an Indian tribal government is treated as a state for certain purposes. Likewise, a subdivision of an Indian tribal government is treated as a political subdivision of a state if the subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.

However, a tribal government is not a "state" for purposes of Section 218 and is not eligible for a Section 218 Agreement.

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.

Mandatory Exclusions – See Required Exclusions.

Mandatory Medicare Health Insurance – Medicare tax and coverage not included as part of a Section 218 Agreement; imposed on all state and local government employees hired or rehired after March 31, 1986.

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

Medicare – Federally established health insurance program for people age 65 and older and certain people with disabilities. Part A (Hospital Insurance) is financed through employer and employee taxes on covered wages/self-employment or by individual payment of monthly premiums. Part B

(Supplemental Medical Insurance) is financed by individuals paying monthly premiums.

Medicare Qualified Government Employment (MQGE) – Services of state and local government employees subject to Medicare tax but not to Social Security tax.

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

National Conference of State Social Security Administrators (NCSSSA) – Professional association of State Social Security Administrators. These state officials are authorized by state law to administer Section 218 Agreements with the SSA and are responsible for all other activities associated with federal and state laws addressing Social Security and Medicare coverage of state and local public employers. Additional duties of

individual State Administrators vary from state to state.

Non-Covered Employment – Employment not covered by Social Security under the Social Security Act and the IRC.

Nonproprietary Function – Governmental activity integral to the operation of a state or political subdivision, for example, maintaining order or levying tax (distinguished from activity of a private or commercial venture).

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

OASDI Taxes – Taxes imposed under IRC Section 3101(a) on employees and IRC Section 3111(a) on employers to help fund the OASDI program. These taxes are called "Social Security taxes" on IRS forms such as

Form W-2 and the amount of wages subject to these taxes are “Social Security wages.”

Optional Exclusions – Categories of services that, under the Social Security Act, may be included or excluded from coverage under a Section 218 Agreement at the option of the state.

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

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

Proprietary Function – Function of a governmental entity, such as a business venture for profit or in competition with private industry, or other discretionary act on behalf of citizens, that by its nature is not an integral governmental activity.

Public Retirement System – (Also called a "FICA replacement plan") A plan, fund or system established by a state or political subdivision for the purpose of providing retirement benefits to employees that meets the tests under IRC Section 3121(b)(7)(F) and Treas. Reg. 31.3121(b)(7)-2(e). A public retirement system may be a pension, annuity, retirement or similar system. For this purpose, it is irrelevant whether a public retirement system is a "qualified plan" within the meaning of ERISA.

Qualified Participant – An individual who is (or has been) a participant in a public retirement system and who has a total accrued benefit under the retirement system

that meets the minimum retirement benefit requirements of IRC Section 3121(b)(7) and regulations thereunder. Treas. Reg. 31.3121(b)(7)-2(d) establishes standards for defined contribution retirement systems. See Revenue Procedure 91-40 for safe-harbor formulas for defined benefit retirement systems.

Required (previously referred to as Mandatory) Exclusions – Categories of services that are not covered for Social Security under Sections 210 and 218 of the Social Security Act. These exclusions should not be confused with the different set of exclusions that apply to those services not covered under the Section 210 mandatory Social Security provisions.

Retirement System – See Public Retirement System.

Retirement System Coverage Group – A group of employees whose positions are covered under a retirement system by

referendum under the provisions of Section 218(d). The retirement system does not need to meet the tests under IRC Section 3121(b)(7)(F) and Treas. Reg. 31.3121(b)(7)-2(e) to secure coverage under a Section 218 Agreement.

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

Self-Employment Contributions Act (SECA) – (IRC Sections 1401-1403) Federal statute imposing tax on the net earnings of

self-employed individuals to fund Social Security and Medicare.

Social Security Act (Act) – Federal statute providing OASDI and Hospital Insurance (Medicare), as well as other benefits.

Social Security Administration (SSA) – An independent agency in the executive branch of the federal government responsible for administering the OASDI insurance program and for determining eligibility for Medicare benefits.

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

Social Security Number (SSN) – The identification number assigned by the SSA 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.

State – For purposes of a Section 218 Agreement, one of the 50 states, Puerto Rico, the Virgin Islands and interstate instrumentalities. The term, for this purpose, does not include the District of Columbia, Guam or American Samoa.

State Social Security Administrator (SSSA) – The principal state official authorized by state law to administer the Section 218 Agreement with the SSA, responsible for all other activities associated with applicable federal and state laws addressing Social Security and Medicare by state and local public employers in the state.

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

Wage Base – The maximum amount of wages of each worker that is subject to OASDI tax in any calendar year. This is also referred to as the Social Security wage base and is adjusted annually. There has been no wage base limit for Medicare since 1994.

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

more than one state. See “Interstate Instrumentality.”

Windfall Elimination Provision (WEP) – A Social Security benefit formula that may be applied to workers who receive both a Social Security retirement or disability benefit and a pension based on work not covered under Social Security. The WEP benefit formula produces a lower Social Security retirement or disability insurance benefit.

Appendix

The following pages contain important documents referred to in the text. Many other related documents may be found at www.IRS.gov and www.SSA.gov.

Amended Section 530 of the Revenue Act of 1978

a. ***Termination of Certain Employment Tax Liability.***

1) In general.

- If -

(A) for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and

(B) in the case of periods after December 31, 1978, all federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such

period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then, for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

2) Statutory standards providing one method of satisfying the requirements of paragraph (1).

- For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

(A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

(B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

3) Consistency required in the case of prior tax treatment.

- Paragraph (1) shall not apply with respect to the treatment of any individual for employment tax purposes for any period ending after December 31, 1978, if the taxpayer (or a predecessor) has

treated any individual holding a substantially similar position as an employee for purposes of the employment taxes for any period beginning after December 31, 1977.

4) Refund or credit of overpayment.

- If refund or credit of any overpayment of an employment tax resulting from the application of paragraph (1) is not barred on the date of the enactment of this Act (Nov. 6, 1978) by any law or rule of law, the period for filing a claim for refund or credit of such overpayment (to the extent attributable to the application of paragraph (1)) shall not expire before the date 1 year after the date of the enactment of this Act (Nov. 6, 1978).

b. ***Prohibition Against Regulations and Rulings on Employment Status.***

- No regulation or Revenue Ruling shall be published on or after the date of the enactment of this Act (Nov. 6, 1978) and before the effective date of any law hereafter enacted clarifying the employment status of individuals for purposes of the employment taxes by the Department of the Treasury (including the Internal Revenue Service) with respect to the employment status of any individual for purposes of the employment taxes.

c.***Definitions.***

- For purposes of this section -

1) Employment tax. - The term ‘employment tax’ means any tax imposed by subtitle C of the Internal Revenue Code of 1986 (formerly I.R.C. 1954, section 3101 et seq. of this title).

2) Employment status. - The term ‘employment status’ means the status

of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an employee).

d. ***Exception.***

- This section shall not apply in the case of an individual who, pursuant to an arrangement between the taxpayer and another person, provides services for such other person as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work.

e. ***Special Rules For Application of Section.***

1) NOTICE OF AVAILABILITY OF SECTION

- An officer or employee of the Internal Revenue Service shall, before or at the commencement of any audit inquiry

relating to the employment status of one or more individuals who perform services for the taxpayer, provide the taxpayer with a written notice of the provisions of this section.

2) RULES RELATING TO STATUTORY STANDARDS

- For purposes of subsection (a)(2) -

(A) a taxpayer may not rely on an audit commenced after December 31, 1996, for purposes of subparagraph (B) thereof unless such audit included an examination for employment tax purposes of whether the individual involved (or any individual holding a position substantially similar to the position held by the individual involved) should be treated as an employee of the taxpayer,

(B) in no event shall the significant segment requirement of subparagraph

(C) thereof be construed to require a reasonable showing of the practice of more than 25 percent of the industry (determined by not taking into account the taxpayer), and

(C) in applying the long-standing recognized practice requirement of subparagraph (C) thereof-

i such requirement shall not be construed as requiring the practice to have continued for more than 10 years, and

ii a practice shall not fail to be treated as long-standing merely because such practice began after 1978.

3) AVAILABILITY OF SAFE HARBORS

- Nothing in this section shall be construed to provide that subsection (a) only applies where the individual involved is otherwise an employee of the taxpayer.

4) BURDEN OF PROOF-

(A) IN GENERAL

- If-

i a taxpayer establishes a prima facie case that it was reasonable not to treat an individual as an employee for purposes of this section, and

ii the taxpayer has fully cooperated with reasonable requests from the Secretary of the Treasury or his delegate,

then the burden of proof with respect to such treatment shall be on the Secretary.

(B) EXCEPTION FOR OTHER REASONABLE BASIS

- In the case of any issue involving whether the taxpayer had a reasonable basis not to treat an individual as an employee for purposes of this section, subparagraph (A) shall only apply for

purposes of determining whether the taxpayer meets the requirements of subparagraph (A), (B), or (C) of subsection (a)(2).

5) PRESERVATION OF PRIOR PERIOD SAFE HARBOR

- If -

(A) an individual would (but for the treatment referred to in subparagraph (B)) be deemed not to be an employee of the taxpayer under subsection (a) for any prior period, and

(B) such individual is treated by the taxpayer as an employee for employment tax purposes for any subsequent period, then, for purposes of applying such taxes for such prior period with respect to the taxpayer, the individual shall be deemed not to be an employee.

6) SUBSTANTIALLY SIMILAR POSITION

- For purposes of this section, the determination as to whether an individual holds a position substantially similar to a position held by another individual shall include consideration of the relationship between the taxpayer and such individuals.

Revenue Procedure 85-18

SECTION 1. PURPOSE

The purpose of this revenue procedure is to amplify and supersede Rev. Proc. 81-43, 1981-2 C.B. 616, which provides instructions for implementing the provisions of section 530 of the Revenue Act of 1978, 1978-3 (Vol. 1) C.B. xi, 119 (the Act), relating to the employment tax status of independent contractors and employees.

SEC. 2. BACKGROUND

1. Rev. Proc. 81-43 is superseded to reflect changes made to section 530 of the Act by section 269(c) of the Tax Equity and Fiscal Responsibility Act of 1982, 1982-2 C.B. 462, 536, which extends the provisions of section 530 indefinitely.

Section 530(a)(1) of the Act, as amended, provides that if, for purposes of the employment taxes under subtitle C of the Internal Revenue Code, a taxpayer did not treat an individual as an employee for any period, then the individual will be deemed not to be an employee for that period, unless the taxpayer had no reasonable basis for not treating the individual as an employee. For any period after December 31, 1978, the relief applies only if (1) all federal tax returns (including information returns) required to be filed by the taxpayer with respect to the individual for the period are filed on a basis

consistent with the taxpayer's treatment of the individual as not being an employee, and (2) the treatment is consistent with the treatment for periods beginning after December 31, 1977.

2. A new section 3.02 titled "Filing of Returns" has been added stating that relief under section 530(a)(1) of the Act will not be granted if a Form 1099 has not been timely filed for each worker for any period after December 31, 1978.
3. Section 3.05 (relating to refunds, credits, and abatements) is clarified to state that it does not apply to periods in which a taxpayer "treated" an individual as an employee.

SEC. 3. APPLICATION

1. "Safe Haven" Rules

There are several alternative standards that constitute "safe havens" in determining

whether a taxpayer has a “reasonable basis” for not treating an individual as an employee. Reasonable reliance on any one of the following “safe havens” is sufficient:

(A) judicial precedent or published rulings, whether or not relating to the particular industry or business in which the taxpayer is engaged, or technical advice, a letter ruling, or a determination letter pertaining to the taxpayer; or

(B) a past Internal Revenue Service audit (not necessarily for employment tax purposes) of the taxpayer, if the audit entailed to assessment attributable to the taxpayer’s employment tax treatment of individuals holding positions substantially similar to the position held by the individual whose status is at issue (a taxpayer does not meet this test if, in the conduct of a prior audit, an assessment attributable to the taxpayer’s treatment of the individual was offset by other claims asserted by the taxpayer); or

(C) long-standing recognized practice of a significant segment of the industry in which the individual was engaged (the practice need not be uniform throughout an entire industry).

A taxpayer who fails to meet any of the three "safe havens" may nevertheless be entitled to relief if the taxpayer can demonstrate, in some other manner, a reasonable basis for not treating the individual as an employee. In H.R. Rep. No. 95-1748, 95th Cong., 2d Sess. 5 (1978), 1978-3 (Vol. 1) C.B. 629, 633, it is indicated that "reasonable basis" should be construed liberally in favor of the taxpayer.

2. Filing of Returns.

For any period after December 31, 1978, the relief under section 530(a)(1) will not apply, even if the taxpayer has met the "safe haven" rules of paragraph 3.01 of this revenue procedure, if the appropriate Form 1099 has not been timely filed with respect to the

workers involved. See Rev. Rul. 81-224, 1981-2 C.B. 197.

3. Interpreting the Word “Treat”

In determining whether a taxpayer did not “treat” an individual as an employee for any period within the meaning of section 530(a)(1) of the Act, the following guidelines should be followed:

(A) The withholding of income tax or the Federal Insurance Contributions Act (FICA) tax from an individual’s wages is “treatment” of the individual as an employee, whether or not the tax is paid over to the Government.

(B) Except as provided in paragraph (C) and (E) below, the filing of an employment tax return (including Forms

940 (Employer’s Annual Federal Unemployment Tax Return), 941 (Employer’s Quarterly Federal Tax Return), 942

(Employer's Quarterly Tax Return for Household Employees), 943 (Employer's Annual Tax Return for Agricultural Employees), and W-2 (Wage and Tax Statement)) for a period with respect to an individual, whether or not tax was withheld from the individual, is "treatment" of the individual as an employee for that period.

(C) The filing of a delinquent or amended employment tax return for a particular tax period with respect to an individual as a result of Service compliance procedures is not "treatment" of the individual as an employee for that period. For this purpose, Collection or Examination activities constitute compliance procedures. For example, if the Service determines as a result of an audit that a taxpayer's workers are common law employees, that determination is not "treatment" of the workers as employees for the period under audit. However, if the taxpayer withholds employment taxes or files

employment tax returns with respect to those workers for the periods following the period under audit, the action is “treatment” of the workers as employees for those later periods.

(D) Internal Revenue Service Center notices that merely advise the taxpayer that no return has been filed and request information from the taxpayer are not compliance procedures.

(E) A return prepared by the Service under section 6020(b) of the Code is not “treatment” of an individual as an employee; nor is the signing of an audit Form 2504 (Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment).

4. Consistency in prior periods

The relief under section 530(a)(1) of the Act, as amended, does not apply to the employment tax treatment of any individual for any period ending after December 31,

1978, if the taxpayer (or a predecessor) treated any individual holding a substantially similar position as an employee for employment tax purposes for any period beginning after December 31, 1977. However, relief will not be denied under the consistency provision for any periods prior to the period in which the individuals were treated as employees. For example, a taxpayer did not treat an individual as an employee in 1978 and 1979. In 1980, the taxpayer began treating individuals holding substantially similar positions as employees. This subsequent treatment does not prevent the taxpayer from receiving relief under section 530(a)(1) for 1978 and 1979. The application of the consistency rule prevents taxpayers from changing the way they treat workers solely to take advantage of the relief provisions. The application of this provision to predecessors is intended to prevent evasion of this rule, for example, by reincorporations.

5. Refunds, Credits, and Abatements

Relief under section 530(a)(1) of the Act is available to taxpayers who are under audit by the Service or who are involved in administrative (including Appellate) or judicial processes with respect to assessments based on employment status reclassifications. Relief also is extended to any claim for a refund or credit of any overpayment of an employment tax resulting from the termination of liability under section 530(a)(1), provided the claim is not barred on the date of enactment of this provision (November 6, 1978) by any law or rule of law.

Taxpayers who have entered into final closing agreements under section 7121 of the Code or compromises under section 7122 with respect to employment status controversies are ineligible for relief under the Act, unless they have not completely paid their liability. Thus, for example, a taxpayer who has agreed to or compromised a liability for an

amount which is to be paid in installments, but who still has one or more installments to pay, is relieved of liability for such outstanding installments. Taxpayers who settled employment status controversies administratively with the Service on any basis other than section 7121 or 7122 of the Code or who unsuccessfully litigated such cases also are eligible for relief, provided their claims are not barred by the statute of limitations or by the application of the doctrine of *res judicata*. However, unpaid judgments will be abated if section 530(a)(1) of the Act applies. Thus, an unsuccessful litigant in an employment status case who fulfills the Act's requirements can avoid collection of any unpaid employment tax liabilities, regardless of the doctrine of *res judicata*.

The application of the doctrine of *res judicata* will prevent a refund based on section 530(a)(1) of the Act if a taxpayer paid a

judgment in an action relating to the same issue as to the same taxpayer. Thus, if the specific matter was judicially decided and the judgment paid, relief under section 530(a)(1) is not available.

This subsection will not apply to those periods in which a taxpayer "treated" an individual as an employee within the meaning of subsection .03 of this section. .

6. Handling of Claims

Relief under section 530(a)(1) of the Act applies to the taxes imposed on an employer by sections 3111 or 3301 of the Code. It also applies to an employer's liability under section 3102 and 3403 to withhold and pay the taxes imposed by sections 3101 and 3402. Therefore, an unpaid assessment of those taxes against an employer who qualifies for relief under section 530(a)(1) of the Act should be abated. Timely claims for refund of such taxes paid by a taxpayer who qualifies for relief will be honored. .

7. Interest and Penalties

If a taxpayer is relieved of liability under section 530(a)(1) of the Act, any liability for interest or penalties attributable to that liability is forgiven automatically. This relief from interest and penalties applies whether charged directly against the taxpayer or personally against a corporate taxpayer's officers.

8. Status of Workers

Section 530 of the Act does not change in any way the status, liabilities, and rights of the worker whose status is at issue. Section 530(a)(1) terminates the liability of the employer for the employment taxes but has no effect on the workers. It does not convert individuals from the status of employee to the status of self-employed.

Section 31.3102-1(c) of the regulations provides, with respect to the collection and payment of the employee's share of the FICA

tax, that "until collected from him [by [*10] the employer] the employee is also liable for the employee tax with respect to all wages received by him." Therefore, if an employer's liability under section 3102 of the Code for the employee's share of the tax imposed by section 3101 is terminated under section 530(a)(1) of the Act, the employee remains liable for that tax. Employees who incorrectly paid the self-employment tax (section 1401 of the Code) may file a claim for refund; however, the amount of the self-employment tax refund will be offset by the amount of the employee's share of the tax imposed on the employee as a result of the application of section 31.3102-1(c) of the regulations.

9. Definition of Employee

For purposes of section 530(a) of the Act, the term employee means employees under sections 3121(d), 3306(i), and 3401(c) of the Code.

SEC. 4.EFFECT ON OTHER DOCUMENTS

Rev. Proc. 81-43 is amplified and superseded.

Revenue Ruling 2003-46

Section 3121.--Definitions

Federal Insurance Contributions Act (FICA); Medicare. This ruling provides that for the continuing employment exception to the Medicare portion of the Federal Insurance Contributions Act tax to apply to service performed by an employee of a state, political subdivision, or instrumentality thereof, such employee must be a member of a retirement system pursuant to Internal Revenue Code section 3121(b)(7)(F). Rev. Ruls. 86-88 and 88-36 supplemented.

The Federal Insurance Contributions Act (FICA) tax consists of an old age, survivors, and disability insurance (“OASDI”) portion and a hospital insurance (“Medicare”) portion. This revenue ruling provides guidance

concerning the applicability of the Medicare portion of FICA tax under Internal Revenue Code § 3121(u)(2) to employees of state and local governments. Specifically, this revenue ruling considers the interaction between § 3121(u)(2)(C) and 3121(b)(7)(F) in the context of the continuing employment exception. Section 3121(u)(2) generally extends the Medicare portion of FICA tax to wages for service performed by employees of states, political subdivisions, and wholly owned instrumentalities thereof hired after March 31, 1986. Section 3121(b)(7)(F), enacted by section 11332(b) of the Omnibus Budget Reconciliation Act of 1990 (OBRA '90), Pub. L. 101-508, 104 Stat. 1388, expands the definition of employment for FICA tax purposes to include service performed after July 1, 1991, by state or local government employees who are not members of a retirement system.

This revenue ruling supplements Rev. Rul. 86-88, 1986-2 C.B. 172, and Rev. Rul. 88-36, 1988-1 C.B. 343, both of which provide guidelines concerning the application of § 3121(u)(2) in a question and answer format. This revenue ruling also provides guidelines in a question and answer format. 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.

SERVICE ELIGIBLE FOR THE CONTINUING EMPLOYMENT EXCEPTION

Q1. Is the continuing employment exception to the Medicare portion of FICA tax available for service performed by an employee for a state employer or political subdivision employer who is not a member of a retirement system within the meaning of § 3121(b)(7)(F)?

A1. No. Under § 3121(u)(2)(C)(i), the continuing employment exception applies only to service that is otherwise excluded from employment under § 3121(b)(7). Section 3121(b)(7) excepts from employment service in the employ of a state employer or political subdivision employer for FICA tax purposes. However, § 3121(b)(7)(F) expands the definition of employment for FICA tax purposes to include service by an employee who is not a member of a retirement system. See § 31.3121(b)(7)-2 of the Employment Tax Regulations. The House-Senate Conference Report to OBRA '90 provides that] "the conference agreement extends Medicare coverage to, and applies the HI [(Medicare)] tax with respect to wages of, those employees (otherwise not already subject to the HI tax) who become subject to OASDI by

reason of this provision." H.R. Rep. No. 101-964, at 1105 (1990). Consequently, wages paid for service performed by an employee who is not a member of a retirement system for the state employer or political subdivision employer are subject to the OASDI and Medicare portions of FICA tax regardless of when the employee became employed.

Q2. Is the continuing employment exception available for service performed by an employee for a state employer or political subdivision employer who is subject to the Medicare portion of FICA tax solely because the employee is not a member of a retirement system (i.e., the employee meets all the requirements of § 3121(u)(2)(C), and the employee's service is not covered by a voluntary agreement with the Secretary of Health and Human Services

pursuant to § 218 of the Social Security Act, 42 U.S.C. § 418), but who becomes a member of a retirement system after July 1, 1991?

A2. Yes. If an employee's wages are subject to FICA tax solely because the employee is not a member of a retirement system within the meaning of § 3121(b)(7)(F), and the employee subsequently becomes a member

of a retirement system, then the employee's wages will cease to be subject to the OASDI and Medicare portions of FICA tax.

EFFECT ON OTHER REVENUE RULINGS:

This revenue ruling supplements Rev. Rul. 86-88, 1986-2 C.B. 172, and Rev. Rul. 88-36, 1988-1 C.B. 343.

[*5]

DRAFTING INFORMATION

The principal author of this revenue ruling is Patricia P. Holdsworth of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Holdsworth at (202) 622-6040 (not a toll-free call).

Revenue Ruling 86-88

FICA; HOSPITAL INSURANCE; EXTENSION TO STATE AND POLITICAL SUBDIVISION EMPLOYEES

This revenue ruling provides guidelines concerning the applicability of the Medicare tax to employees of states and political subdivisions.

For purposes of this revenue ruling, the term ‘state’ includes the Commonwealth of Puerto

Rico, the Virgin Islands, and the District of Columbia.

For purposes of this revenue ruling, the term ‘political subdivision’ has the same meaning that it has under section 218(b) (2) of the Social Security Act, 42 U.S.C. section 418(b)(2). Thus, ‘political subdivision’ ordinarily includes a county, city, town, village, or school district. In many states, depending upon the manner in which such entities are created under state law, ‘political subdivision’ includes a sanitation, utility, reclamation, improvement, drainage, irrigation, flood control, or similar district.

For purposes of this revenue ruling, the term ‘state employer’ of a state includes the state and any agency or instrumentality of that state that is a separate employer for purposes of withholding, paying, and reporting the federal income taxes of employees. The term ‘political subdivision employer’ of a political subdivision includes the political subdivision

and any agency or instrumentality of that political subdivision that is a separate employer for purposes of withholding, reporting, and paying the federal income taxes of employees.

SERVICES SUBJECT TO THE MEDICARE TAX

Q1. What services are subject to the Medicare tax under the Act?

A1. As a general rule, services performed for a state employer or political subdivision employer by an employee hired by the state employer or political subdivision employer after March 31, 1986, are subject to the Medicare tax. The following services, however, are NOT subject to the Medicare tax even though the services are performed by an employee hired after March 31, 1986:

(1) services covered by an agreement between the state and the Secretary of Health and Human Services entered into pursuant to section 218 of the Social Security Act, 42 U.S.C. section 418 (218 agreement) providing for social security coverage including Medicare,

(2) services excluded from the definition of employment under any provision of sections 3121(b) of the Code other than sections 3121(b)(7),

(3) services performed by an individual who is employed by a state employer (except for a District of Columbia employer) or a political subdivision employer to relieve the individual of unemployment,

(4) services performed in a hospital, home, or other institution by a patient or inmate thereof as an employee of a

state employer or a political subdivision employer,

(5) services performed by an individual as an employee of a state employer or a political subdivision employer serving on a temporary basis in case of fire, storm, snow, earthquake, flood, or other similar emergency, or

(6) services performed by any individual as an employee included under section 5351(2) of title 5, United States Code (relating to certain interns, student nurses, and other student employees of the District of Columbia government), other than as a medical or dental intern or a medical or dental resident in training.

THE CONTINUING EMPLOYMENT EXCEPTION

Q2. If an employee was hired before April 1, 1986, by a state employer or a political subdivision employer and services are performed for the state employer or political subdivision employer by that employee after March 31, 1986, are those services subject to the Medicare tax?

A2. Services are not subject to the tax if they are performed after March 31, 1986, for a state employer or political subdivision employer by an employee who was hired by the state employer or the political subdivision employer before April 1, 1986, and if the employee meets the following requirements:

(i) the employee was performing regular and substantial services for remuneration for the state employer or political subdivision employer before April 1, 1986,

(ii) the employee was a bona fide employee of that employer on March 31, 1986,

(iii) the employment relationship with that employer was not entered into for purposes of avoiding the Medicare tax, and

(iv) the employment relationship of the employee with that employer has not been terminated after March 31, 1986 (other than as provided in the rules described in Q&A8 below, which concern employees who transfer from one state employer, or one political subdivision employer, to another).

Section 3121(u)(2)(C) of the Code

For purposes of this revenue ruling, this exception to the Medicare tax is called the 'continuing employment exception.'

Q3. An employee signed an employment contract before April 1, 1986, but did not begin to perform services until after March 31, 1986. Does the employee qualify for the continuing employment exception?

A3. No. The employee does not qualify for the continuing employment exception because the employee was not performing regular and substantial services for remuneration before April 1, 1986. Section 3121(u)(2)(C)(ii)(I) of the Code.

Q4. Before April 1, 1986, an individual was performing services for remuneration as a substitute teacher on an 'as needed' basis for a state employer or a political subdivision employer, and the individual continued performing those services on that basis after March 31, 1986. Does

the individual qualify for the continuing employment exception?

A4. No. The individual does not qualify for the continuing employment exception. Even though the services performed may have been substantial, the services were not regular because they were performed on an 'as needed' basis. Section 3121(u)(2)(C)(ii)(I) of the Code.

Q5. A was a state employee performing regular and substantial services for remuneration prior to April 1, 1986. A's employment relationship with the state employer was terminated after March 31, 1986. but A was later rehired by the state employer. Does the continuing employment exception apply to A?

A5. No. Section 3121(u)(2)(C)(iii) of the Code.

Q6. How is termination of employment defined for purposes of determining whether the Medicare tax is applicable?

A6. The question of whether an employment relationship has terminated is a question of fact that must be determined on the basis of all the relevant facts and circumstances.

Great weight, however, will be given to the personnel rules of the state employer or political subdivision employer to determine whether an employment relationship has been terminated.

Q7. An employee who was hired before April 1, 1986, by a state employer transferred after March 31, 1986, to another state employer of that state. The transfer was made without a termination of the

employee's overall employment relationship with that state. Does the employee qualify for the continuing employment exception?

A7. Yes. An employee hired before April 1, 1986, by a state employer who transfers after March 31, 1986, to another state employer of that state may qualify for the continuing employment exception, provided the transfer was made without a termination of the employee's overall employment relationship with that state. The same rule applies to an employee hired before April 1, 1986, by a political subdivision employer, who transfers after March 31, 1986, to another political subdivision employer of that political subdivision.

On the other hand, an employee hired before April 1, 1986, does not qualify for the continuing employment exception if after

March 31, 1986, the employee transfers from a state employer to a political subdivision employer or from a political subdivision employer to a state employer. Likewise, an employee does not qualify for the exception if the employee transfers from a political subdivision employer in one political subdivision to a political subdivision employer in a different political subdivision, or from a state employer in one state to a state employer in a different state. Section 3121(u)(2)(D) of the Code.