



# Federal-State Reference Guide

## A Federal-State Cooperative Publication

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

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

# Introduction

The Federal-State Reference Guide provides state and local government employers a comprehensive reference source on Social Security and Medicare coverage and federal tax withholding issues. The guide was first published by the Internal Revenue Service (IRS) in 1995 with assistance from the State of Colorado and is a cooperative effort of the Social Security Administration (SSA), the IRS and the National Conference of State Social Security Administrators (NCSSSA). Topics addressed in this publication include determination of worker status, public retirement systems (FICA replacement plans), Social Security and Medicare coverage and benefits, agreements under Section 218 of the Social Security Act (Section 218 Agreements), employment tax laws and other tax issues. The tax information generally applies to federal agencies, with some exceptions; for example, the discussion of employment that is subject to Social Security and Medicare taxes, including the Section 218 Agreement information, and the discussion of relief under Section 530 of the Revenue Act of 1978 (Section 530 relief) doesn't apply to federal agencies.

All IRS forms and publications mentioned in this publication can be ordered without charge from the IRS at 800-829-3676, or can be downloaded at [www.irs.gov/forms](http://www.irs.gov/forms). Governmental taxpayers may get assistance with general or account-related questions by calling Customer Account Services at 877-829-5500, Monday through Friday.

This publication also includes information for Indian tribal governments. Federal tax law establishes the role of Indian tribal governments as employers. Tribal governments are required to follow substantially the same procedures as other employers. Tribes are not eligible for Section 218 Agreements; however, tribes may apply to SSA to have wages paid to tribal council members covered by an agreement under section 218A of the Social Security Act (Section 218A Agreement). Other special statutory provisions apply to tribal governments. For more information about Indian tribal governments, visit [IRS.gov/tribes](http://IRS.gov/tribes). Publication 4268, Employment Tax for Indian Tribal Governments, addresses employment tax issues for tribal governments.

Frequently asked questions appear at the end of each chapter of this publication. After each answer, the primary contact for the topic is indicated - IRS, SSA or STATE.

The Federal-State Reference Guide is for informational and reference purposes only. This content cannot be used or cited as authority for assuming, or attempting to sustain, a technical position on employment tax, Social Security benefits or other legal issues. Valid citations of authority for technical matters are:

- The Internal Revenue Code (IRC);
- Certain statutory tax provisions affecting the IRC that are not actually part of the IRC (off-IRC provisions, such as Section 530 of the Revenue Act of 1978) and the Social Security Act (Act); and
- Regulations, other published administrative guidance (such as rulings) and case law related to these laws.

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Revenue Procedure 85-18  
Revenue Ruling 2000-6  
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## ■ Chapter 1

# Social Security and Government Employers

Federal tax requirements generally apply to public employers in the same way that they do to private employers. However, there are some differences arising from the unique history of laws governing Social Security and Medicare coverage for state and local government employees. Special provisions apply to the application of these taxes as well as certain withholding requirements.

## Historical Overview

Social Security taxes were first collected in 1937. The funding mechanism for the Social Security program was officially established in the Internal Revenue Code (IRC) as the Federal Insurance Contributions Act (FICA). Under the original Social Security Act of 1935, state and local government employees were excluded from Social Security coverage because of unresolved legal questions about the federal government's authority to impose taxes on state and local governments and their employees.

Beginning in 1951, states could enter into voluntary agreements with the federal government to provide Social Security coverage to public employees. These arrangements are called "Section 218 Agreements" because they are authorized by Section 218 of the Social Security Act. Originally, government entities filed with the SSA, but since 1987, the IRS has been responsible for collecting these taxes from governmental employers. All 50 states, Puerto Rico, the Virgin Islands and approximately 60 interstate instrumentalities have Section 218 Agreements with SSA, providing varying degrees of coverage for employees in the state.

Social Security coverage of government employees varies greatly from state to state. In 22 states, at least 90% of state and local government employees work in positions covered by Social Security. By contrast, in Alaska, California, Colorado, Louisiana, Massachusetts, Ohio, Nevada and Texas, less than half of state and local government employees are covered. As of 2014, 28.1% of the state and local government workforce, or 6.4 million state and local government employees were not covered by Social Security.

The largest portion of uncovered government employees work at the local level. Most uncovered local government public employees are police officers, firefighters and teachers.

The following chart includes the major historical developments since state and local employees first became eligible for Social Security coverage in 1951.

## Key Dates

<b>January 1, 1951</b>	Beginning this date, states could voluntarily elect Social Security coverage for public employees not covered under a public retirement system (FICA replacement plan) by entering into a Section 218 Agreement with SSA. Prior to this date, there was no mandatory Social Security coverage.
<b>January 1, 1955</b>	Beginning this date, states could extend Social Security coverage to employees (other than police officers and firefighters) covered under a public retirement system.
<b>July 1, 1966</b>	Beginning this date, employees covered for Social Security under a Section 218 Agreement are automatically covered for Medicare.
<b>April 20, 1983</b>	Beginning this date, coverage under a Section 218 Agreement cannot be terminated unless the governmental entity is legally dissolved.
<b>April 1, 1986</b>	State and local government employees hired on or after this date, not already covered, are mandatorily covered for Medicare, unless the position is specifically excluded by law. For state and local government employees hired before April 1, 1986, Medicare coverage may be elected under a Section 218 Agreement.
<b>January 1, 1987</b>	Beginning this date, State Social Security Administrators are no longer responsible for collecting Social Security contributions from public employers or for verifying and depositing the taxes owed by public employers. After 1986, public employers pay FICA taxes directly to the IRS in the same manner as do private employers.
<b>July 2, 1991</b>	Beginning this date, state and local government employees became subject to mandatory Social Security and Medicare coverage, unless they are (1) members of a qualifying public retirement system, or (2) covered under a Section 218 Agreement.
<b>August 15, 1994</b>	The Social Security Independence and Program Improvements Act of 1994 established the SSA as an independent agency, effective March 31, 1995. This Act also increased the FICA exclusion amount for election workers from \$100 to any amount less than the threshold amount mandated by law in a calendar year. (To verify the current year amount, see the <a href="#">SSA website</a> .) States were authorized to amend their Section 218 Agreements to increase the FICA exclusion amount for election workers to the statutorily mandated threshold. This Act also amended Section 218 to allow all states the option to extend Social Security and Medicare coverage to police officers and firefighters who participate in a public retirement system. (Under previous law, only 23 states were authorized to do so.)
<b>October 21, 1998</b>	Public Law 105-277 provided a 3-month period for states to modify their Section 218 Agreements to exclude from coverage services performed by students. This provision was effective July 1, 2000, for states that exercised the option to take this exclusion.
<b>March 2, 2004</b>	Public Law 108-203 requires public employers to furnish Form SSA-1945 to public employees hired after December 31, 2004, informing them that they are earning retirement benefits not covered by Social Security; also closed the Government Pension Offset (GPO) loophole, effective April 1, 2004.

## Key Public Employer Responsibilities

The following are the major responsibilities that apply to all public employers, regardless of their Social Security coverage and public retirement system:

- Properly classify workers as either independent contractors or employees.
- Solicit and collect valid taxpayer identification numbers from all employees and payees.
- Determine which employees are exempt from Social Security and/or Medicare taxes.
- Withhold, report and pay appropriate Social Security and Medicare taxes, or Medicare-only taxes, for each employee.
- Obtain clarifications of laws, regulations and other appropriate information from State Social Security Administrators, IRS and SSA.

## Considerations for Social Security Coverage (Section 218 and Mandatory)

Social Security coverage can vary widely within a state or even a local area. Do not make an assumption about Section 218 Agreement coverage for an entity and whether it complies with all applicable laws merely because of the status of a similar entity, either in the same or a different state. For Section 218 Agreement coverage questions, contact your State Social Security Administrator (see [www.NCSSSA.org](http://www.NCSSSA.org)). Related information can also be found at [SSA State and Local Government Employers](#).

In general, to determine the correct coverage for a group of employees, a government employer must address the following questions:

If employees **are** covered by a Section 218 Agreement:

1. When did the state enter into a Section 218 Agreement to elect Social Security coverage for a particular political subdivision?
2. What optional exclusions and what coverage groups were listed in that Agreement or later modification?
3. Does the political subdivision have more than one modification?
4. Did the state or political subdivision terminate voluntary Social Security coverage in its entirety or for any coverage groups before April 20, 1983?
5. Has the state elected to provide Medicare-only coverage for a particular entity?

If employees **are not** covered by a Section 218 Agreement:

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

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\*Throughout this publication, the term “public retirement system” (also known as FICA replacement plan) refers to a retirement system administered by a state, political subdivision or instrumentality thereof that meets the requirements of IRC Section 3121(b)(7)(F). See [Revenue Procedure 91-40](#). For Section 218 purposes, it is irrelevant whether the retirement system meets the minimum benefit standards for a qualified plan under the Employee Retirement Income Security Act (ERISA). See [Chapter 6](#).

**Note:** In some situations, legal challenges occur that are resolved in the federal courts. It’s even possible that, while cases are pending, the application of the laws can vary and be applied by the IRS and SSA solely in one state (if a case has been heard and decided in a federal district court) or in states only in one federal circuit (if a case has been heard and decided at the federal circuit court level). It’s important in these situations to be aware of which federal district or circuit court has jurisdiction over federal laws that apply to each state. To locate a map and contact information for federal courts, see [www.uscourts.gov/court\\_locator](http://www.uscourts.gov/court_locator).

## Steps to Determine Social Security and Medicare Coverage of State and Local Government Employees

State and local government employees may be covered for Social Security and Medicare under either a Section 218 Agreement, which applies to anyone holding the affected position, or under mandatory coverage, which is based on the individual employee's situation.

If the position is covered under a Section 218 Agreement, any employee occupying that position is covered. This is the first coverage consideration for a governmental employer. If, however, the position is not covered under a Section 218 Agreement, then the employer must determine whether mandatory FICA coverage applies. To do this, the employer must first determine whether the employee is deemed to be a member of a public retirement system (FICA replacement plan). This is a critical consideration in determining whether and how a Section 218 Agreement or mandatory FICA coverage applies to an employee.

The following steps outline how a public employer should determine whether Social Security and Medicare coverage or Medicare-only coverage applies to an employee.

- Step 1:** Determine whether the employee's position is covered by a Section 218 Agreement ([Chapter 5, Social Security and Medicare Coverage](#)).\* If yes, the employee is covered for Social Security and Medicare under the Agreement, unless an exclusion applies for that position. If no, proceed to the next step.
- Step 2:** If the employee's position is not covered under a Section 218 Agreement, determine whether the employee is a member of a public retirement system ([Chapter 6, Social Security and Public Retirement Systems](#)). If no, the employee is subject to mandatory Social Security and Medicare, unless an exclusion applies. If yes (the employee is a member of a public retirement system), the employee is exempt from mandatory Social Security. Medicare is mandatory for public employees hired or rehired after March 31, 1986, regardless of membership in a public retirement system. Proceed to the next step to determine Medicare coverage for any employee hired before April 1, 1986.
- Step 3:** Determine whether a Section 218 Agreement provides Medicare only coverage for employees hired before April 1, 1986. If yes, the employee is covered for Medicare only. If no, proceed to the next step.
- Step 4:** Determine whether the Medicare continuing employment exception applies to the employee ([Chapter 5](#)). If yes, the employee is exempt from mandatory Medicare. If no, the employee is subject to mandatory Medicare, unless an exclusion applies.

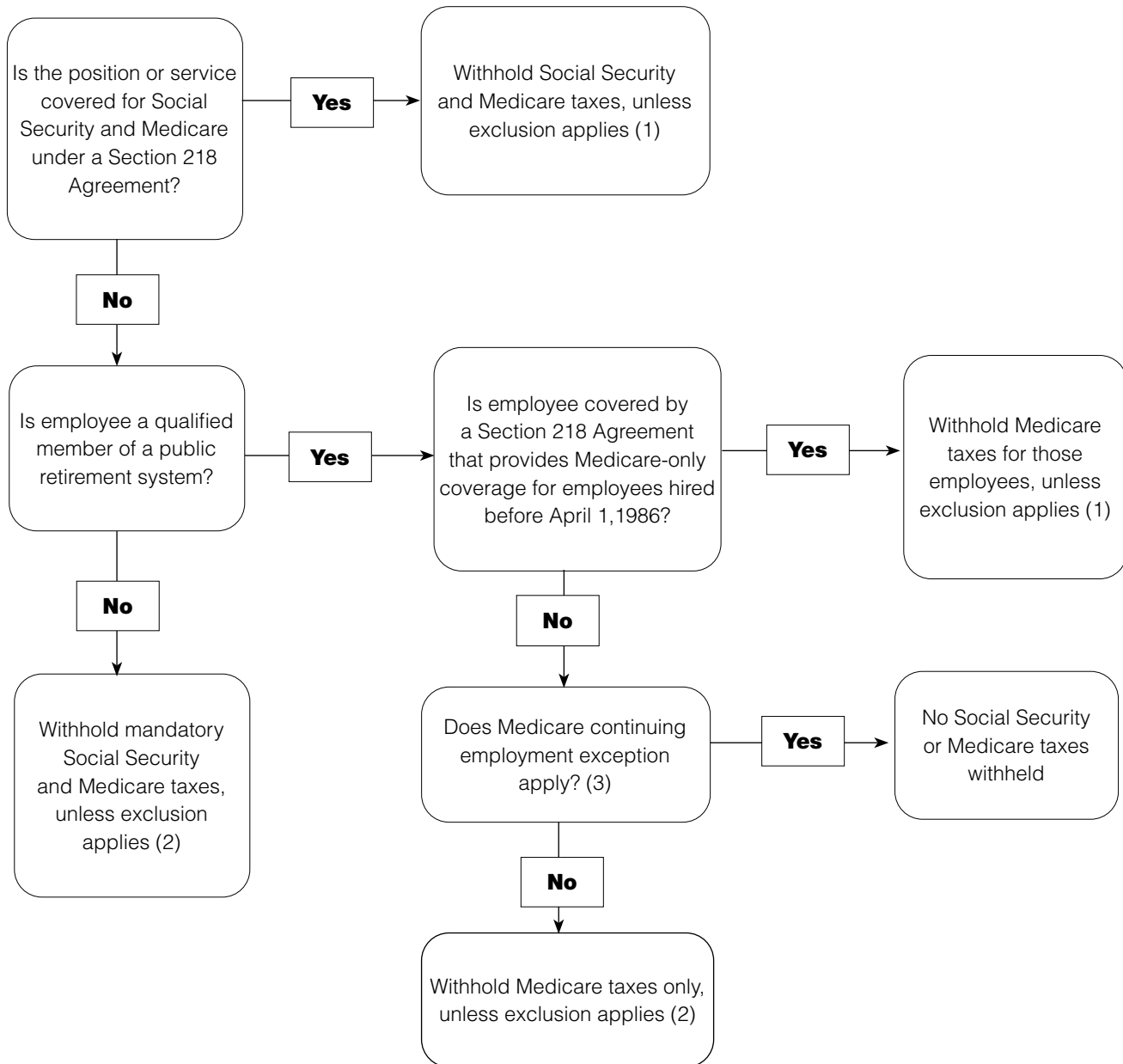
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\* State enabling legislation can have an effect on positions and entities covered by the particular state's Section 218 Agreement. Consult the appropriate state's enabling legislation to determine which positions are eligible for coverage under that state's Section 218 Agreement. For a list of state enabling statutes, see the [Appendix](#) of this publication.

The following flowchart illustrates these steps:

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

This chart is a guide only and is not a substitute for discussing complex Section 218 Agreement coverage situations with your State Social Security Administrator or FICA taxation issues with your IRS agent.



- (1) Section 218 required and optional exclusions (see [Chapter 5](#))
- (2) Exclusions from mandatory Social Security and Medicare (see [Chapter 5](#))
- (3) Medicare continuing employment exception (see [Chapter 5](#))



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

The Social Security Administration (SSA) is responsible for administering the Social Security Act, including the interpretation of individual Section 218 Agreements. SSA also administers benefits and maintains individual earnings records. See [Chapter 7](#), Social Security Administration.

The Internal Revenue Service (IRS) is responsible for administering the Internal Revenue Code, which includes the Federal Insurance Contributions Act (FICA), advising employers of their responsibilities, collecting taxes and working with SSA and State Social Security Administrators on Social Security coverage and related tax issues. See [Chapter 8](#), Internal Revenue Service.

The State Social Security Administrator (SSSA) is the designated official legally appointed to act for the state in negotiations with the SSA. This official acts 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 on the administration of the agreement. Each state's Section 218 Agreement and Social Security Regulation 404.1204 provide a legal obligation for each state to designate an official. In many states the actual day-to-day responsibilities are delegated to the staff of the designated state official. See [Chapter 9](#), State Social Security Administrators.

**Public employers** are responsible for:

- Properly classifying workers as either independent contractors or employees
- Soliciting and collecting valid taxpayer identification numbers from all employees and payees
- Determining which employees are exempt from Social Security and/or Medicare taxes
- Withholding, reporting and paying appropriate Social Security and Medicare taxes, or Medicare-only taxes for each employee
- Obtaining clarifications of laws, regulations and other information from State Social Security Administrators, IRS and SSA

### **Where to Direct Questions**

The IRS, SSA and State Social Security Administrator have different responsibilities and areas of authority in dealing with issues on Social Security coverage, taxation and reporting.

The following indicates the primary point of contact for many common questions.

#### **Topics for the IRS:**

- Federal income tax
- Worker classification (employee or independent contractor)
- Collection of Social Security and/or Medicare tax
- Completion and filing of Forms W-2, W-3, 1099 and 1096
- Employment tax returns (Forms 941, 944)
- Definition of public retirement system (FICA replacement plan)
- Whether an employee is covered by mandatory Social Security
- Whether certain payments are subject to Social Security and/or Medicare tax
- Questions about employer identification numbers

#### **Topics for the SSA:**

- Social Security benefits
- Section 218 coverage

- Individual earnings records and quarters of coverage
- Verification of Section 218 terms
- Form W-2 records
- Problems with Social Security number

### Topics for the SSSA:

- Existence and/or terms of a Section 218 Agreement
- Modifications to the Section 218 Agreement
- Treatment of a specific position under a Section 218 Agreement
- Other issues involving interpretation of state law

## Frequently Asked Questions

### 1. What is a Section 218 Agreement?

A Section 218 Agreement is a written, voluntary agreement between one of the 50 states (or Puerto Rico, the Virgin Islands or an interstate instrumentality) and the SSA under Section 218 of the Social Security Act. This agreement provides Social Security and Medicare, or Medicare-only coverage for designated groups of state and local government employees. The term refers to the original agreement and all subsequent modifications. These agreements can cover services of employees who are covered by a public retirement system as well as those who are not. To determine whether your entity is covered under a Section 218 Agreement, or can execute one, contact your State Social Security Administrator. See the list of State Administrators at [NCSSSA.org](http://NCSSSA.org). [SSA/STATE]

### 2. How may a Section 218 Agreement affect employees who are qualifying members of a public retirement system?

An agreement may provide Social Security and Medicare coverage for employees already covered by a public retirement system (or FICA replacement plan). This may include:

- a. Employees covered by a public retirement system who elect coverage under a referendum. The Social Security and Medicare coverage applies in addition to retirement system coverage.
- b. Employees performing services that are excluded from mandatory Social Security coverage provisions, but are only optionally excluded under Section 218 Agreements, such as student services, and services of election workers who earn less than the threshold amount.
- c. [Election workers](#) in some state Section 218 Agreements that establish a dollar threshold for [FICA coverage](#) that's lower than the federal statutory requirement.
- d. Employees hired before April 1, 1986, who meet the continuing employment Medicare exception. [STATE]

### 3. Why might a Section 218 Agreement be modified?

Modifications to Section 218 Agreements are necessary to include additional coverage groups, to cover additional services in a group already covered (services previously optionally excluded), to cover ineligible, to cover employees changing to the "Yes" group in a divided retirement system, to cover previously terminated groups, or to identify political subdivisions joining a covered public retirement system. See [Chapter 5](#). [STATE]

### 4. I was told by the State Social Security Administrator that my town is covered for Social Security under the state's Section 218 Agreement and the coverage cannot be terminated. Is this true?

Yes. By law after April 20, 1983, coverage under a Section 218 Agreement cannot be terminated. Beginning July 2, 1991, any state and local government employees not covered for Social Security under a Section 218 Agreement who are not qualified members of a public retirement system (FICA replacement plan), are covered under **mandatory** Social Security. [STATE/SSA]

### 5. Are Indian tribal government employers eligible to enter into Section 218 Agreements?

No, Indian tribal governments are not considered states or subdivisions of states for Section 218 purposes. See IRC Section 7871. However, the [Tribal Social Security Fairness Act of 2018](#) (PDF) provides information about Indian tribes wishing to offer Social Security coverage to tribal council

members per Section 218A of the Social Security Act. For more information about Social Security coverage, Medicare and tribal governments, see the [IRS Indian Tribal Governments](#) website. [IRS]

**6. I have a question about Social Security and Medicare coverage requirements for employees of my city. Whom do I contact?**

The State Social Security Administrator should always be your first contact on any questions about coverage under Social Security or Medicare. Consult SSA if you need additional assistance on coverage. Direct questions about whether specific services are subject to mandatory Social Security and Medicare taxes to the IRS. [STATE]

**7. What is the responsibility of State Social Security Administrators for non-Section 218 entities?**

Under Section 218 of the Act, the primary legal responsibility State Social Security Administrators have is for Section 218 entities. However, the Administrator's responsibilities to entities not covered under the state's Section 218 Agreement (non-Section 218 entities) vary from state to state. Some State Administrators may not interact with non-Section 218 entities, while in other states the State Administrator may perform monitoring, quasi-regulatory and enforcement functions for them. If a non-Section 218 entity needs information about coverage under an agreement, contact the State Social Security Administrator. [STATE]

**8. If an entity has a Section 218 Agreement in effect, and joins the state's public employee retirement system, does Section 218 Agreement coverage continue?**

After April 20, 1983, a Section 218 Agreement cannot be terminated for any reason as long as that entity exists. The addition of a retirement system does not affect employee coverage under the Section 218 Agreement. [SSA]

## ■ Chapter 2

# Government Entities and Federal Taxes

The Bureau of the Census collected data showing that there were approximately 89,000 units of local government in the United States in 2012. These units of government employ more than 20% of the American workforce.

This chapter discusses the legal basis for different types of government entities and the specific tax questions that arise in connection with them. Many tax laws apply differently to government entities than to other organizations and individuals.

The income of certain government entities, including states, political subdivisions of states, or integral parts of states or political subdivisions, is generally exempt from tax. The income of other government entities, such as instrumentalities, might be excludable from gross income under IRC Section 115 if that income is derived from the exercise of an essential governmental function and accrues to a state or political subdivision of a state.

Certain government entities, such as colleges or universities, that are agencies or instrumentalities of a state or political subdivision of a state, are subject to the tax on unrelated business income under IRC Section 511. For more information, see [Publication 598](#), Tax on Unrelated Business Income of Exempt Organizations.

## State Government

States are recognized as entities by the U.S. Constitution. However, different definitions of a state apply for different legal purposes. Federal employment taxes generally apply to all 50 states, the District of Columbia and all U.S. Territories. For purposes of a Section 218 Agreement, a state may refer to any of the 50 states, Puerto Rico, the Virgin Islands and interstate instrumentalities. For this purpose, the definition of a state does not include the District of Columbia, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands or Indian tribal governments.

## Authority

The states have primary responsibility for many aspects of government. The 10th Amendment to the U.S. Constitution reserves to the states, or to the people, all powers not delegated to the federal government nor prohibited by the Constitution. 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 and roads within the state
- Regulation of business within the state
- Education and maintenance of schools within the state
- Condemnation of property through eminent domain within the state

In many cases, the federal and state governments share responsibility, with the federal government providing most of the funding and the state distributing the services. Some common services involving shared responsibility include:

- Health care
- Public assistance for persons in need
- Protection of natural resources
- Improvement in living and working conditions

## Local Government and Political Subdivisions

Local governments are generally political subdivisions of states. They differ from state and federal governments in that their authority is not based directly on a constitution. Each state constitution governs the procedure for the establishment of local governments. In most cases, the state legislature must approve the creation or incorporation of a local government. The local government then receives a charter defining its organization, authority and responsibilities, including the means for electing governing officials.

Local government units bear a variety of names, such as city, county, township, village, parish, borough or district. The legal significance of these terms may vary from state to state.

### Authority

The authority of local governments varies greatly among the states and individual jurisdictions. Generally, a local government has the authority to:

- Impose taxes
- Try people accused of breaking local laws or ordinances
- Administer local programs within its boundaries

In addition to funding provided by local taxes, fees and other sources, local governments receive financial aid from state and federal governments in providing these services according to need.

Some of the services that local governments take primary responsibility for providing include:

- Conducting and coordinating elections
- Maintaining public safety
- Building and repairing local roads and streets
- Providing police and fire protection
- Collecting garbage and recycling
- Ensuring the safety of drinking water
- Maintaining courts, courthouses and jails
- Collecting state and local government taxes
- Keeping official records, such as for marriage, birth and death

## Instrumentalities

An instrumentality is an organization separate from, but affiliated with, a state or local government. It may or may not be created by or pursuant to state statute, but it is operated for public purposes. Generally, an instrumentality performs governmental functions, but does not have the full powers of a government, such as police authority, taxation and eminent domain (sovereign powers). Direct questions on the legal status of an instrumentality, for federal tax or Social Security and Medicare purposes, to the IRS. Address questions on a specific Section 218 Agreement to the State Social Security Administrator or the SSA (see [Chapter 7](#)).

A wholly-owned instrumentality of one or more states or political subdivisions is treated as a state or local government employer for purposes of the mandatory Social Security and Medicare provisions of IRC Section 3121(b)(7)(F).

### Interstate Instrumentalities

An interstate instrumentality is an independent legal entity organized by two or more states to carry on governmental functions. Examples include a regional planning authority, transportation system or water district. For purposes of Section 218 Agreements, an interstate instrumentality is treated as a state.

A referendum (vote) for Social Security and/or Medicare coverage must be held prior to the execution of a Section 218 Agreement for interstate instrumentality employees in positions under a retirement system. All interstate instrumentalities are authorized to hold a referendum using either a majority vote or a divided system retirement process. (see [Chapter 5](#) for referendum procedures). Employees of an interstate instrumentality who are not covered for Social Security under a Section 218 Agreement, but who are qualified participants in a public retirement system, are not covered for Social Security even if the employer incorrectly continues to withhold and report Social Security taxes.

### **Characteristics of Instrumentalities**

In Revenue Ruling 57-128, 1957-1 C.B. 311, the IRS addressed the question of whether an organization is a wholly-owned instrumentality of one or more states or political subdivisions. This revenue ruling established the following factors as relevant to a determination of whether the entity is an instrumentality of a government:

- Whether it is used for a governmental purpose and performs a governmental function
- Whether performance of its function is on behalf of one or more states or political subdivisions
- Whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner
- Whether control and supervision of the organization is vested in public authority or authorities
- The degree of financial autonomy and the source of operating expenses
- Whether express or implied statutory or other authority is necessary for its creation and/or use of the instrumentality, and whether that authority exists

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

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

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

To determine the status of an entity, it is essential to review the documents that establish statutory authority. The following cases elaborate on the principles established in Revenue Ruling 57-128.

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

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

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

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

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

**Example:** Under the laws of the state of Pennsylvania, townships have the authority to purchase fire engines and fire apparatus out of general township funds for use of the township and to appropriate money to fire companies located in the township to secure fire protection. These volunteer fire companies are instrumentalities under Pennsylvania state law, and the members of volunteer fire departments are employees of the political subdivision. [Revenue Ruling 70-484, 1970-2 C.B. 202]

**Associations that Promote a State or Municipality** - State sponsorship of promotional activities is not sufficient to raise an association to instrumentality status.

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

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

## Indian Tribal Governments

The legal relationship between the United States and Indian tribal governments is set forth in the Constitution, treaties, statutes and court decisions. Congress may limit the authority of Indian tribal governments, but within those limits, the tribal governments retain attributes of sovereignty over both their members and their territory. Generally, Indian tribal governments provide government services, such as transportation, education and medical care to its members.

### Authority

Tribal governmental power includes the authority to:

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

### Employment Taxes

Generally, Indian tribal governments should follow general rules that apply to nongovernmental entities for employment tax. [Publication 15](#) (Circular E), [Employer's Tax Guide](#), and [Publication 15-A](#), [Employer's Supplemental Tax Guide](#), provide the basic rules for employers. There are, however, some special employment tax rules that apply to Indian tribal governments:

- An exception applies to the definition of "employment" for FUTA purposes for services performed in the employ of an Indian tribe (IRC Section 3306(c)(7)). An Indian tribe may elect to make contributions to the state unemployment fund as if services by its employees were employment under FUTA, or it may make payments in lieu of the contributions to reimburse the state for benefits paid former employees of the tribe. An Indian tribe may make separate elections for any subdivision, subsidiary or business enterprise wholly owned by it. If an

Indian tribe fails to make either form of payment within 90 days of receiving a notice of delinquency, or if it fails to post a required payment bond, then service for the tribe is not excepted from “employment” until the failure has been corrected (IRC Section 3309(d)). For this purpose, the term “Indian tribe” has the meaning given in 25 USC Section 450b(e) (Section 4(e) of the Indian Self-Determination and Education Assistance Act), and includes any subdivision, subsidiary or business enterprise wholly-owned by an Indian tribe (IRC Section 3306(u)).

Amounts paid to members of Indian tribal councils for services performed as council members are generally not wages for purposes of FICA and income tax withholding, although these amounts are includible in gross income. ([Revenue Ruling 59-354](#)). The [Tribal Social Security Fairness Act of 2018](#) authorizes SSA to enter into voluntary agreements with Indian tribes to provide individual tribal council members with Social Security coverage. Visit [SSA.gov](#) for more information.

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

Information addressing Indian tribal governments and employment tax issues can be found in [Publication 4268](#), Employment Tax for Indian Tribal Governments.

## Frequently Asked Questions

### 1. How is the tax treatment of governments different from that of other entities?

The income of certain government entities, including states, political subdivisions of states, or integral parts of states or political subdivisions, is generally not taxable. The income of other government entities, such as instrumentalities, might be excludable from gross income under IRC Section 115 if that income is derived from the exercise of an essential governmental function and accrues to a state or political subdivision of a state. Colleges and universities that are agencies or instrumentalities of any government, or any political subdivision of government, or that are owned or operated by a government or political subdivision of a government, are subject to tax on unrelated business income. [IRS]

### 2. Can the IRS issue a letter indicating that our entity is a tax-exempt government?

For a government entity to receive an official determination of its status as a political subdivision, instrumentality of government, or whether its income is excludable from gross income under IRC Section 115, it must obtain a private letter ruling (PLR) by following the procedures in [Rev. Proc. 2020-1](#) (updated annually). There is a fee to receive a PLR. [IRS]

As a service to government entities, IRS can issue a “governmental information letter” free of charge. This letter describes government entity exemption from federal income tax and cites the IRC sections on deductible contributions and income exclusion. Most organizations and individuals will accept the governmental information letter as the substantiation required for these purposes. Contact IRS Customer Account Services at 877-829-5500. [IRS]



## Wage Reporting and Employment Taxes

A government entity that has employees needs to be familiar with the basic responsibilities and requirements that apply to all employers, as well as some provisions that are unique to governments. This chapter briefly covers the main types of compensation that are included in employee wages and the requirements for tax withholding and payments. Tax requirements for employers are discussed in [Publication 15](#), (Circular E), Employer's Tax Guide. This chapter highlights some key requirements for employers and matters of special interest to governmental employers.

All governmental entities that employ workers are subject to federal employment taxes on wages, except where the law provides specific exceptions. The Internal Revenue Code defines wages subject to income tax withholding under Section 3401 and defines wages for Social Security and Medicare tax purposes under Section 3121. As discussed in [Chapter 2](#), a broad exception exempts government employment from federal unemployment tax (FUTA).

Social Security and Medicare taxes, also referred to as FICA taxes, consist of Old-Age, Survivors and Disability Insurance (OASDI, or Social Security) and Hospital Insurance (Medicare) taxes. IRC Section 3101 imposes taxes on the employee, and Section 3111 imposes taxes on the employer. State or local entities covered by Social Security and Medicare must withhold and pay over the employee share of the taxes and must pay the employer share. Under Section 3402, employers are also generally required to withhold income tax from wages.

In general, all compensation provided to an employee is included in taxable wages unless an exception is provided by law. An exception may apply for FICA taxes, or federal income tax withholding, or both. The following discussion addresses the treatment of certain forms of compensation, focusing on some that are of interest to government employers.

### Social Security and Medicare Wages

IRC Section 3121(a) provides that wages include all remuneration for employment, whether paid in cash or in some other form, unless specifically excluded by statute. Examples of wages for Social Security and Medicare purposes include salaries, fees, stipends, bonuses, prizes, awards and commissions. It is immaterial whether the payments are based on the hour, week, month, year, piecework, percentage of revenue or other system.

An important exception is provided by IRC Section 3121(b)(7)(F), which excludes services performed by state and local government employees from Social Security tax if the employee's services are not covered under a Section 218 Agreement (voluntary Social Security coverage) and if the employee is a qualifying member of a public retirement system (FICA replacement plan) as described in Treas. Reg. Section 31.3121(b)(7)-2. Chapters 5 and 6 discuss the application of the tax to governmental employees.

The Social Security Administration establishes the maximum amount of wages subject to the Social Security tax each year. This amount is [updated annually](#) and is \$137,700 in 2020. Since 1994, there has been no wage base limit for Medicare tax.

## Social Security, Medicare and Additional Medicare Tax Rates and Limits

<b>Social Security and Medicare Tax</b>					
	2016	2017	2018	2019	2020
<b>Social Security Tax (OASDI) Information</b>					
Employee Rate	6.20%	6.20%	6.20%	6.20%	6.20%
Employer Rate	6.20%	6.20%	6.20%	6.20%	6.20%
Maximum Wages Subject to Tax	\$118,500	\$127,200	\$128,400	\$132,900	\$137,700
<b>Medicare Tax Information</b>					
Employee Rate	1.45%	1.45%	1.45%	1.45%	1.45%
Employer Rate	1.45%	1.45%	1.45%	1.45%	1.45%
Maximum Wages Subject to Tax	No maximum (applies to all wages)				
<b>Additional Medicare Tax Information</b>					
Employee Rate	0.9%	0.9%	0.9%	0.9%	0.9%
Employer Rate	N/A	N/A	N/A	N/A	N/A
Withholding Threshold	Wages that exceed \$200,000 in a calendar year				

### Additional Medicare Tax

As of 2013, a 0.9% Additional Medicare Tax applies to Medicare wages over a threshold amount based on the taxpayer's filing status. However, an employer must withhold Additional Medicare Tax from wages in excess of \$200,000 it pays to an employee in a calendar year, without regard to the employee's filing status or wages paid by another employer.

Unlike Social Security and basic Medicare taxes, there is no employer match for Additional Medicare Tax.

An employer is required to begin withholding Additional Medicare Tax in the pay period in which it pays wages in excess of \$200,000 to an employee and continue withholding it until the end of the calendar year.

For more information on Additional Medicare Tax, see [Questions and Answers for the Additional Medicare Tax](#).

[Chapter 5](#) also discusses in detail the application of Social Security and Medicare to the compensation of governmental employees.

### Other Forms of Cash Compensation

In addition to salary or wages, employees may receive cash in other ways. Some common forms of cash compensation include:

## Sick Pay

Sick pay is an amount paid to an employee because of inability to work due to sickness or injury. Sick pay is generally subject to Social Security and Medicare taxes the same as other remuneration paid to the employee, regardless of whether the employer or a third party pays the sick pay. Sick pay paid by an employer is also subject to income tax withholding. The employer withholds income tax from sick pay based on the employee's [Form W-4](#), Employee's Withholding Certificate.

Sick pay is sometimes paid by a third party, such as an insurance company or employee trust. The rules on third-party withholding, paying and reporting Social Security and Medicare taxes differ, depending upon whether:

- The third party is acting as an agent of the employer or an independent insurer, and
- The terms of an agreement between the employer and agent or insurer.

If the third party paying sick pay is an agent of the employer, the third party is generally required to withhold income tax from the sick pay. If the third-party payer is not an agent of the employer, the third-party payer is not required to withhold income tax, unless the employee requests that income tax be withheld by completing and giving the third party a [Form W-4S](#), Request for Federal Income Tax Withholding From Sick Pay.

See [Publication 15-A](#), Employer's Supplemental Tax Guide, for more details on third-party sick pay.

The following types of sick pay or injury pay are not subject to Social Security and Medicare taxes:

1. Payments received under a workers' compensation act, or under a statute in the nature of a workers' compensation act.
2. Payments, or portions of payments, attributable to the employees' contributions to a sick pay plan.
3. Payments on account of sickness or injury made by, or on behalf of, an employer more than six months after the last calendar month in which the employee worked for the employer.

## Vacation Pay

Vacation pay is wages and is subject to Social Security, Medicare and income tax withholding. When vacation pay is paid in addition to regular wages for the vacation period, withhold on the vacation pay as a supplemental wage payment. See Section 7, "Supplemental Wages," in [Publication 15](#).

## Military Differential Pay

Military differential pay is payment:

- Made by an eligible employer to a qualified individual for any period the individual is called to active duty in the uniformed services for a period of more than 30 days, and
- Represents part or all the wages the individual would have received from the employer if the individual were performing services for the employer during that time.

Differential wage payments are treated as wages for income tax withholding but aren't subject to Social Security, Medicare or FUTA taxes. Employers should report differential wage payments in Box 1 of Form W-2. For more information about the tax treatment of differential wage payments, see [IRS Revenue Ruling 2009-11](#).

## Deceased Employee's Wages

If an employee dies during the year, the employer must report the accrued wages, vacation pay and other compensation paid after the date of death. Also, report wages that were available to the employee while they were alive, regardless of whether the wages were in the employee's possession, as well as any other regular wage payment, even if it is necessary to reissue the payment in the name of the estate or beneficiary. How the payment is reported depends on the year in which payment is made.

**Payment made in the year of death** - If you made the payment after the employee's death but in the same year the employee died, you must withhold Social Security and Medicare taxes on the payment and report the payment on the

employee's Form W-2 only as Social Security wages (box 3) and Medicare wages and tips (box 5) to ensure proper Social Security and Medicare taxes withheld in boxes 4 and 6. Do not show the payment in box 1.

**Payment made after the year of death** - 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 you made the payment in the year of death or after the year of death, report it in box 3 of Form 1099-MISC, Miscellaneous Income, as a payment to the estate or beneficiary. Use the name and taxpayer identification number (TIN) of the estate or beneficiary on Form 1099-MISC.

See the [Instructions for Form W-2](#) and [Publication 559](#), Survivors, Executors, and Administrators, for more information on the treatment of payments on behalf of a decedent.

## Back Pay

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

**SSA treatment of back pay under a statute** - Under the law, the SSA credits back pay awarded under a statute (for example, under the Americans with Disabilities Act or Fair Labor Standards Act) to an individual's earnings record in the periods the wages should have been paid. However, payments of back pay under a statute will be posted to the employee's Social Security earnings record in the year reported on Form W-2 unless the employer or employee notifies the SSA in a special, separate report. If this is done, SSA can then allocate the statutory back pay to the appropriate periods for purposes of retirement benefit calculations. This is important because wages not credited to the proper year may result in lower Social Security benefits or failure to meet the requirements for benefits. See [Publication 957](#), Reporting Back Pay and Special Wage Payments to the Social Security Administration, for more information.

## Workers' Compensation

Amounts received by police officers, firefighters and other employees or their survivors for personal injuries or sickness incurred in the course of employment are excludable from income, Social Security and Medicare taxes if they are paid under a workers' compensation act or a statute in the nature of a workers' compensation act that provides compensation to employees for personal injuries or sickness incurred during employment.

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

## Noncash Payments

Generally, noncash payments are wages subject to income, Social Security and Medicare tax. The dollar value of wages paid in a medium other than cash should be computed based on the fair market value of the property at the time of the payment. The fair market value may be based on the prevailing value of the item in the locality or on a reasonable value established for other purposes. Special rules may apply to noncash fringe benefits.

## Fringe Benefits

Fringe benefits, which generally include any compensation other than cash wages or salary, must be included in an employee's wages unless the law provides an exception. A fringe benefit is a form of pay for the performance of services. For example, you provide an employee with a fringe benefit when you allow the employee to use a business vehicle to commute to and from work.

**Provider of benefit** - You're the provider of a fringe benefit if it's provided for services performed for you. You're considered the provider of a fringe benefit even if a third party, such as your client or customer, provides the benefit to your employee for services the employee performs for you. Thus, you are responsible for any employment tax liability related to the fringe benefit if it's provided for services performed for you.

Examples of employer-provided fringe benefits include, but are not limited to:

- Vehicles for personal use
- Meals
- Health or life insurance
- Tickets to entertainment or sporting events
- Holiday gifts
- Personal use of employer facilities
- Transportation (commuting) benefits and passes
- De minimis (minimal) benefits
- Tuition reduction
- Educational assistance
- Dependent care assistance
- Employee discounts
- Employer-provided cell phones
- Moving expense reimbursements
- Achievement awards

The tax treatment of some of these benefits is determined by specific statutes; others fall under general rules for broader categories of fringe benefits. [Publication 15-B](#), Employer's Tax Guide to Fringe Benefits, addresses fringe benefits for all employers. In addition, [Publication 5137](#), Fringe Benefit Guide, addresses fringe benefits for government employers.

### **Business Expense Reimbursements – Accountable Plan**

Payments to employees for travel and other ordinary and necessary expenses of the employer's business generally are wages subject to Social Security and Medicare taxes and income tax withholding unless they are made under an accountable plan. There are three requirements for a reimbursement to be treated as being paid under an accountable plan:

1. The expenses must qualify as deductible business expenses incurred while performing services for the employer,
2. The employee must adequately account for the expenses to the employer within a reasonable period of time, and
3. The employee must return any amounts received that exceed expenses within a reasonable period of time.

See [Publication 15](#) and [Publication 5137](#) for more information on accountable plans.

The use of per diem rates at or below the federal rate for travel expenses can reduce and simplify the recordkeeping requirements for accounting for these expenses. See [Publication 463](#), Travel, Gift, and Car Expenses, or [Publication 5137](#) for more information on per diem reimbursement systems.

### **Reimbursements Not Made Under Accountable Plan**

If an employer provides reimbursements that do not comply with the accountable plan rules, these amounts are treated as wages and subject to employment taxes the same as other pay of the employee.

## Retirement Plans

Regardless of Social Security coverage, most public employees are covered by some form of retirement plan. The terms of these plans may vary, but in general provide for tax-deferred income placed in trust for the benefit of employees. These plans may involve employee or employer contributions, or both. Under certain provisions of the Internal Revenue Code, contributions may be deferred from tax until they are withdrawn. The term “qualified” is used to describe private-sector plans under IRC Section 401 that meet specific provisions of ERISA that enables them to offer certain tax advantages to the participants. Many public employees, however, are covered by nonqualified plans, generally under IRC Sections 403(b) or 457, discussed below and at [Government Retirement Plans Toolkit](#).

## Income Tax Withholding on Qualified Retirement Plans

For income tax withholding purposes, employer and employee contributions made under qualified plans (up to the maximum allowable for the year) are deferred from income tax. The employee is subject to tax on distributions of these amounts when they are withdrawn from the plan. In most cases, withdrawals not rolled over into another plan are subject to mandatory income tax withholding on distribution.

## Employer “Pick-Up” Contributions

IRC Section 414(h)(2) allows state and local government entities with IRC Section 414(d) governmental plans to treat contributions that have been designated as employee contributions, but are “picked up” (paid) by the employer, to be treated as employer contributions, and therefore as excludable from income. These “picked up” contributions are also exempt from Social Security and Medicare tax if they aren’t made under a salary reduction agreement. For more information on the conditions required for employer pick-up, see IRC Section 414(h)(2) or search for “Employer pick-up contributions” on [IRS.gov](#).

## Section 403(b) Plans

Plans under IRC Section 403(b), also called tax-sheltered annuities, are available to certain employees of public schools, employees of tax-exempt organizations and certain ministers. These plans resemble qualified plans in many respects. Many public school employees are covered by 403(b) plans in addition to receiving Social Security coverage under a Section 218 Agreement.

Employer contributions to tax-sheltered annuities under Section 403(b) for public school employees are exempt from Social Security and Medicare taxes, unless the contributions are made by reason of a salary reduction agreement. Eligible participants may defer amounts from income tax up to an [annual limit](#) (\$19,500 in 2020, subject to annual cost of living adjustments (COLA)). This amount may be increased for certain employees with more than 15 years of service. Employees age 50 or older may also make additional tax-deferred “catch-up” contributions.

Employee contributions, including those made by salary reduction arrangements, are subject to Social Security and Medicare tax (See IRC Section 3121(a)(5)(D)).

For more information, see [Publication 571](#), Tax-Sheltered Annuity Plans (403(b) Plans), and the [403\(b\) plan webpage](#) on IRS.gov.

## Section 457 (Nonqualified) Plans

Many public employees participate in nonqualified IRC Section 457 deferred compensation plans. These plans can be established by state and local governments or tax-exempt organizations. If they meet the requirements of Section 457(b), they are considered “eligible” plans; if not they are considered “ineligible” plans and are governed by Section 457(f).

## Section 457(b) – Eligible Plans

Governmental Section 457(b) plans must be funded with assets held in trust for the benefit of employees. Plans eligible under Section 457(b) may defer amounts from income tax up to an [annual limit](#) (\$19,500 in 2020, subject to [COLA](#)).

Governmental Section 457(b) plans may make “catch-up” contributions to employees age 50 or older, in addition to the basic Section 457(b) catch-up.

Social Security and Medicare taxes generally apply to all employer and employee contributions. Amounts deferred from wages into eligible Section 457(b) plans are not subject to income tax withholding until they are distributed from the plan or made available to the participant or beneficiary. See Section VI of [Notice 2003-20](#) and [IRC 457\(b\) Deferred Compensation Plans](#) for more information.

### **Section 457(f) – Ineligible Plans**

Nonqualified state or local government plans that do not meet the requirements of Section 457(b) are ineligible plans, or Section 457(f) plans. There is no limit on the annual deferrals on these plans, but to defer taxation, all deferrals must be subject to substantial risk of forfeiture. Amounts deferred under a Section 457(f) plan are generally subject to Social Security and Medicare taxes at the later of the time 1) when the services giving rise to the related compensation are performed, or 2) when there is no substantial risk of forfeiture of the rights to the amounts.

## **Reporting Responsibilities**

Basic federal tax requirements that generally apply to all employers are discussed below. For a more detailed explanation, see [Publication 15](#).

### **Employer Identification Number (EIN)**

When two entities are combined (for example, when one municipality annexes another, or when school districts are consolidated) the EIN of the annexed area or abolished district should no longer be used, as it is no longer a separate entity. A continuing entity that absorbs or annexes another can retain and use its EIN. However, if a new entity is created from the dissolution of two or more pre-existing entities, the new entity should obtain a new EIN. When an unincorporated area is incorporated, it becomes a separate entity and must obtain its own EIN.

See [Publication 1635](#), Employer Identification Number, Understanding Your EIN, and [About Form 8832, Entity Classification Election](#), for additional information on how to avoid common EIN problems.

Notify the IRS immediately if you change your business name or address. Write to the IRS office where you file your returns, using the *Without a Payment* address provided in the instructions for your employment tax return, to notify the IRS of any business name or address change.

### **Form SSA-1945**

State and local government employers must notify employees hired in jobs not covered by Social Security of the effects of the Windfall Elimination Provision and the Government Pension Offset. Section 419(c) of the Social Security Protection Act of 2004 requires newly hired public employees to sign [Form SSA-1945](#), Statement Concerning Your Employment in a Job Not Covered by Social Security. This indicates they are aware of a possible reduction in their future Social Security benefit entitlement. For more detailed information about this law, see [Chapter 7](#) or Form SSA-1945.

### **Form W-2**

An employer is responsible for furnishing [Form W-2](#), Wage and Tax Statement, to each employee from whom income, Social Security or Medicare tax was withheld, or would have been withheld if the employee had claimed no more than one withholding allowance or had not claimed exemption from withholding on [Form W-4](#), Employee’s Withholding Certificate. The aggregate amounts are reported on [Form W-3](#), Transmittal of Wage and Tax Statements.

Employers are required to send Copy A of Forms W-2 and W-3 to the Social Security Administration by January 31 of the following year for both paper and electronic forms. Employers must furnish Copy B to employees by January 31 of the following year.

Employers who file 250 or more Forms W-2 must file them electronically. Statements may be furnished to employees electronically only if the employee affirmatively consents to it. See [Publication 1141](#), General Rules and Specifications for Substitute Forms W-2 and W-3, for more information.

SSA's Regional Employer Services Liaison Officers (ESLOs) provide assistance with filing Forms W-2 and other wage reporting questions. See [ESLO](#) or call 800-772-6270. Specifications for electronic reporting of Form W-2 information can be found at the [SSA employer page](#).

## Form 941

[Form 941](#), Employer's QUARTERLY Federal Tax Return, is used to report:

- Wages paid,
- Federal income taxes withheld,
- Both the employer's and employees' share of Social Security and Medicare taxes, and
- Additional Medicare tax withheld from employees.

The IRS matches amounts reported on your four quarterly Forms 941 with Form W-2 amounts totaled on your Form W-3. If the amounts don't agree, the IRS or SSA may contact you.

To prepare Form 941, the total wages and compensation for the quarter must be determined. Wage payments are included in the quarter in which they are paid. For example, an employee works for the county in a pay period ending on March 20 but is not paid until April 5. In this situation, the employee's wage payment is included in the second quarter when the payment is made, not the first quarter when the work was done. Special timing rules apply in determining when certain noncash fringe benefits are treated as paid. See [Publication 15-B](#).

Total wages and compensation entered on line 2 of Form 941 include all payments to employees. Examples of these payments include:

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

Wages from which Social Security and Medicare tax must be withheld may differ from total wages. This may be because certain amounts are not included in wages for income tax withholding purposes but are subject to Social Security and Medicare tax (for example, deferred compensation in a nonqualified deferred compensation plan). Another common reason for a difference in the totals is that earnings exceeding the annual wage base are not subject to the OASDI portion of Social Security tax. The total income tax withheld (line 3) includes all federal income tax withheld from all employees for the calendar quarter covered by the return.

Form 941 must be filed with the IRS by the last day of the month following the calendar quarter. For example, the first quarter return covering January through March is due by April 30. See the [Instructions for Form 941](#) for additional information.

## Form 944

Certain taxpayers with small payrolls (those whose annual liability for Social Security, Medicare and withheld federal income taxes is \$1,000 or less) will file and pay these taxes only once a year instead of every quarter. The IRS will notify taxpayers when they must use [Form 944](#), Employer's ANNUAL Federal Tax Return. An employer may contact the IRS to request to file a quarterly Form 941 instead of a Form 944. See [Revenue Procedure 2009-51](#). The deposit requirements, discussed below, are the same for annual and quarterly filers. For more information regarding this form, see [Publication 15](#) or the [Instructions for Form 944](#).



## Form 941-X and Form 944-X

Employers correct errors to Form 941 or 944 by filing [Form 941-X](#), Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund, or [Form 944-X](#), Adjusted Employer's ANNUAL Federal Tax Return or Claim for Refund. These forms are stand-alone returns that should be filed as soon as the error is discovered. The return for the period when the error is discovered is not affected. Additional requirements are discussed in the [Instructions for Form 941](#) and [Form 944](#), as well as in the [Instructions for Form 941-X](#) and [Form 944-X](#).

## Form 945

Nonpayroll federal income tax withholding (reported on Forms 1099 and Form W-2G, Certain Gambling Winnings) must be reported on [Form 945](#), Annual Return of Withheld Federal Income Tax. Separate deposits are required for payroll (Form 941 or Form 944) and nonpayroll (Form 945) withholding. Nonpayroll items include:

- Pensions (including distributions from tax-favored retirement plans, for example, 401(k), 403(b) and governmental 457(b) plans) and annuities
- Payments subject to backup withholding
- Gambling winnings
- Certain other payments, such as unemployment compensation and Social Security, subject to voluntary withholding

## Multiple Employers and the Wage Base

Because each employer must withhold Social Security tax on wages up to the annual maximum, an employee who works for more than one employer in one calendar year may have excess Social Security taxes withheld. To get a refund of the excess Social Security tax withheld by the employers, the employee shows the overpayment on Form 1040, U.S. Individual Income Tax Return. Employers are not responsible for making any adjustments based on wages paid by other employers and cannot claim a refund in this situation, because each employer is responsible for withholding and paying Social Security tax on wages paid to each employee up to the wage base.

## Special Reporting Situations for Government Employers

### Medicare Qualified Government Employment

As explained in [Chapter 2](#), all employees hired after March 31, 1986, are subject to mandatory Medicare tax. Federal, state and local employers that provide coverage under a public retirement system may have employees who are not subject to Social Security but are subject to Medicare tax. This is referred to as Medicare Qualified Government Employment (MQGE).

MQGE Forms W-2 are filed separately from those for employees covered by Social Security and Medicare, or from Forms W-2 having no Social Security or Medicare wages. Paper MQGE Forms W-2 must be transmitted with a covering Form W-3 with "Medicare Govt. Emp." checked in box b. See the [Instructions for Forms W-2 and W-3](#).

### Employees Covered for MQGE and FICA

If they are employed in more than one capacity, some state and local employees may be subject to both Medicare-only withholding and full Social Security and Medicare in the same reporting year. When an employee is in a continuous employment relationship with the same employer for the year, and the employer has both types of employees, the employer has two reporting options:

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

See SSA [Specifications for Filing Forms W-2 Electronically \(EFW2\)](#) for specifics on how to report these various employee wage situations. Special Situations - 2.5 – Government Employer, covers the situations discussed above.

## Information Reporting for Election Workers

If the compensation of an election worker is less than a statutorily established amount that is subject to an adjustment for inflation each year (\$1,900 for 2020), it is generally not subject to mandatory Social Security and Medicare tax (IRC Sections 3121(b)(7)(F)(iv) and 3121(u)(2)(B)(ii)(V)). However, under a state's Section 218 Agreement an election worker's compensation may be subject to Social Security and Medicare taxes at a level below the statutory amount. In any case, compensation of election workers is not subject to income tax withholding.

If an election worker's wages are subject to withholding of Social Security and Medicare tax, Form W-2 reporting is required for all compensation, regardless of the amount. If an election worker's compensation is not subject to withholding of Social Security and Medicare tax, Form W-2 reporting is required for payments that aggregate \$600 or more in a calendar year.

See [Election Workers: Reporting and Withholding](#) and [Revenue Ruling 2000-6](#) for more information.

## Information Returns

Government entities must file with the IRS, and furnish to recipients, information returns for certain types of payments. In most cases, these payments are reported on [Form 1099-MISC](#), Miscellaneous Income or [Form 1099-NEC](#), Nonemployee Compensation.

IRC Section 6041(a) states that all persons engaged in a trade or business and making payment in the course of the trade or business to another person of rent, salaries, wages, premiums, annuities, compensation, remuneration or other fixed and determinable gains, profits and income (with certain exceptions) of \$600 or more in any year must furnish an information return indicating the amount of the income and the name and address of the recipient of the payment.

Common payments that must be reported (payments of \$600 or more) include services, rents, income payments, awards and prizes, and medical and health care payments.

Payees for whom payments must be reported include individuals, partnerships, estates, trusts, and medical and legal service providers.

Never use Form 1099-MISC/Form 1099-NEC to report payments for services by an employee. Only use Forms W-2 and W-3 to report compensation to employees.

The [Form W-9](#), Request for Taxpayer Identification Number and Certification, is used to get the payee's correct name and taxpayer identification number by an individual or entity required to file information returns with the IRS. Obtain this information before payments are made. (See Backup Withholding, below.) Payments for nonemployee compensation are discussed in the [Instructions for Form 1099-MISC and 1099-NEC](#).

Governments must file [Form 1099-G](#), Certain Government Payments, for payments including:

- State or local income tax refunds
- Unemployment compensation
- Taxable grants

See the [Instructions for Form 1099-G](#) for more information.

Taxpayers responsible for filing 10 or more information returns of any one type (for example, Form 1099-MISC or Form 1099-NEC) must file them electronically with the IRS. If a written statement to an information return recipient is required, it may be furnished to them electronically rather than by paper if the recipient consents affirmatively to that and the payer meets necessary requirements. For more details on electronic and other information return requirements, see the [General](#)

[Instructions for Certain Information Returns](#) and [Publication 1220](#), Specifications for Electronic Filing of Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G.

## Backup Withholding

You generally must withhold 24% (starting in 2018, previously 28%) of certain taxable payments if the payee fails to furnish you with their correct TIN prior to payment. This withholding is referred to as “backup withholding” and is reported on Form 945. [Publication 15](#) provides additional information.

## Information Reporting Customer Service Site

You may call 866-455-7438 (toll-free), 304-263-8700 (toll call) or 304-579-4827 (TDD/TTY for persons who are deaf, hard of hearing or have a speech disability) to discuss your questions. You can also reach the center by email at [mccirp@irs.gov](mailto:mccirp@irs.gov). Don't include TINs or attachments in email correspondence because electronic mail isn't secure.

## Depositing Taxes

In general, employers are required to deposit federal employment taxes (federal income tax withheld and both the employer and employee Social Security and Medicare taxes) if the total tax liability for Form 941 or Form 944 for the current or previous quarter (year for Form 944) is \$2,500 or more. These taxes are required to be deposited using the [Electronic Federal Tax Payment System](#) (EFTPS). A balance due on the Form 941 or 944 of less than \$2,500 is not required to be deposited; it may be paid with the return. For more information on using the EFTPS, see IRS [Publication 966](#), [Electronic Federal Tax Payment System A Guide To Getting Started](#).

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

Separate deposits are required for nonpayroll (Form 945) and payroll income tax withholding. Don't combine deposits for Forms 941 (or Form 944) and Form 945 tax liabilities.

The general deposit rules and dollar thresholds that apply to Form 941 also apply to Form 945. However, because Form 945 is an annual return, the rules for determining your deposit schedule (discussed below) are different from those for Form 941. See the Instructions for [Form 945](#) for more information.

## When to Deposit

An employer will use either the monthly or the semiweekly schedule for depositing Social Security, Medicare and withheld income taxes. These schedules determine when a deposit is due after a tax liability arises (a payday). Before the beginning of each calendar year, employers must determine which of the two deposit schedules they must use. The deposit schedule used is based on the total tax liability reported on Form 941 during a four-quarter lookback period. The deposit schedule is not determined by how often employees are paid. To determine your payment schedule for Forms 941, 944 and 945, review [Publication 15](#).

## Calculating Federal Income Tax Withholding

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

Each employee should submit a signed [Form W-4](#) when employment begins. The amount of federal income tax withheld on an employee depends on five factors:

1. Payroll period;
2. Employee marital status, as shown on Form W-4;
3. Amount of wages;
4. Number of withholding allowances claimed by the employee on Form W-4; and

5. Additional amounts the employee requests to have withheld.

However, Form W-4 is revised annually. Future revisions of Form W-4 and Publication 15 may provide for a different procedure for determining the amount to withhold.

If a new employee doesn't give you a completed Form W-4, withhold income tax by treating the employee as single with the number of withholding allowances provided for this situation in the current year's revision of Publication 15. For 2020, withhold income tax on employees who don't give you a completed Form W-4 by treating them as single, with no withholding allowances.

[Publication 15](#) contains the tax withholding tables and percentage tables to figure out how much to withhold. It also explains the procedure used in calculating withholding.

## Federal Unemployment Tax Act

The Federal Unemployment Tax Act (FUTA) provides a federal-state insurance system for workers who lose their jobs. Most private employers pay both a federal and state unemployment tax. State and local governments, including their political subdivisions are exempt from FUTA tax. However, state and local government employees, with certain exceptions, must be covered by state unemployment insurance. Contact your state employment or labor agency for more information.

## Interest and Penalties

Tax that isn't paid when due or in the manner required may be subject to civil penalties and interest on the amount due.

### Employment Tax Penalties

The following are the most commonly assessed penalties related to employment tax. There are penalties for filing a return late and paying or depositing taxes late, unless there is reasonable cause.

IRC Section	Penalty Assessed For	Penalty Rates
6651(a)(1)	Failure to file a tax return (failure to timely file)	5% of the tax due per month up to 25%
6651(a)(2)	Failure to pay tax shown on the return (failure to timely pay) (imposed if the amount of tax shown on the return is not paid on or before the prescribed date)	0.5% (1/2 of 1%) of the tax due per month up to 25%
6651(c)	Both failure to timely file and failure to timely pay	When both penalties apply for any month, the failure to file penalty is assessed at 4.5%
6652(b)	Failure to report tips	Imposes a penalty for tip income unreported to the employer; the penalty is 50% of the employee Social Security and Medicare tax on the unreported tip income

IRC Section	Penalty Assessed For	Penalty Rates
6656	Deposit penalties:	
	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)	10%
	Taxes still unpaid after the 10th day following notice and demand	15%
	Failure to deposit electronically	10%
6662	Underpayment of employment taxes due to disregard of the rules and regulations (accuracy-related)	20% of the underpayment attributable to negligence or disregard of rules and regulations
6672	Failure to withhold or pay over trust fund taxes	100% of unpaid tax (see below)

### Trust Fund Recovery Penalty

To encourage prompt payment of withheld income and other employment taxes, IRC Section 6672 provides for the trust fund recovery penalty. These taxes are called trust fund taxes because the employees' money is held in trust until a federal tax deposit is made in that amount. This penalty may be imposed on all persons the IRS determines is responsible for collecting, accounting for and paying over these taxes, and who acted willfully in not doing so. The penalty is the full amount of the unpaid trust fund tax.

A responsible person can be an officer, employee or volunteer. A responsible person also may include one who signs checks for the business or otherwise has authority to cause the spending of funds. Willfully means voluntarily, consciously and intentionally. A responsible person acts willfully if the person knows that the required actions are not taking place.

### Information Reporting Penalties

The penalty rates and maximums for not filing correct information returns or not furnishing correct payee statements, including inflationary adjustments, are reflected at [Increase in Information Return Penalties](#).

Note that these penalties can be substantial amounts, and increased penalties can apply for certain failures in the case of intentional disregard.

### Interest

Interest is assessed on any taxes due and unpaid, in addition to any penalties that may be imposed. However, the law allows an employer who has made an underpayment of Social Security and Medicare taxes or income tax withholding to make an interest-free adjustment (IRC Section 6205(a)(1)). The following requirements must be met:

1. Correction of the error must be made in the period in which the error was ascertained, and
2. Payment of the tax must be made no later than the due date of the return for the return period in which the error was ascertained. Additional tax due as a result of an IRS examination or ruling may qualify for an interest-free adjustment.

See [Revenue Ruling 2009-39](#) for additional information about interest-free adjustments.

## Frequently Asked Questions

**1. If board members are paid nominal amounts, for example, under \$1,000 per year, must Social Security and Medicare taxes be withheld?**

Generally, yes. Elected and most appointed officials are employees of the public entity they serve and are generally subject to the withholding rules that apply to other workers. Withhold Social Security and Medicare taxes for any official who is either 1) covered under a Section 218 Agreement or 2) not a qualified participant in a public retirement system (also called a FICA replacement plan) and therefore subject to mandatory coverage. Any official elected or appointed after March 31, 1986, is subject to Medicare. See [Chapter 4](#) for more information on who is an employee. [IRS]

**2. What is the statute of limitations date for an adjustment or claim for refund of payroll taxes?**

The general rule is that an adjustment or claim for refund of any overpayment of federal payroll taxes must be filed within three years from the date the return was due or three years from the date it was filed, if that date is later. For this purpose, a Form 941 and Form 944 return for any calendar quarter is considered filed on April 15 of the following calendar year, if it's in fact filed by that date. [IRS]

**3. What is the Social Security tax treatment of prison inmate labor?**

Generally, services performed by inmates, for the state or local political subdivision that operates the prison are excluded from Social Security coverage, whether or not performed outside the confines of the prison. Inmates usually are not in an employment relationship with the state or political subdivision. In general, services performed by inmates, as part of the rehabilitative and therapeutic program of the institution, are not usually performed as employees. Services performed by inmates for an entity other than the state or local governmental unit, for example a work-release program, may be covered if an employment relationship exists. The relevant factor for determining Social Security coverage is whether an employer/employee relationship exists between the inmate and the nongovernmental employer, not the place where the inmate is incarcerated. Services performed by inmates outside the institution for the same unit of government that operates it are considered performed in the institution.

**4. Are services of police officers and firefighters considered emergency services that are excluded from Social Security and Medicare coverage?**

Police officers and firefighters are **not** considered emergency workers for purposes of the exclusion from Social Security and Medicare coverage for certain emergency workers. This exclusion applies only to services of an employee who was hired because of an unforeseen emergency to work in connection with that emergency on a temporary basis (for example, an individual hired to battle a major forest fire or to provide emergency assistance in other similar disasters such as volcano eruption, severe ice storm, earthquake or flood). Regular, long-term police and fire employees are not emergency workers for this purpose and subject to the same rules as other public employees to determine whether they are covered by Social Security. [IRS]

**5. How are tax deposits made?**

Deposits of employment taxes must be made electronically. In some cases, employment taxes may be paid with the tax return if the amount of tax is below certain threshold and deposits are not required. See [Publication 15](#), (Circular E), Employer's Tax Guide. [IRS]

## ■ Chapter 4

# Determining Worker Status

It is critical for any entity paying compensation to know whether its workers are properly classified as employees or independent contractors. In some cases, workers may be designated as employees by a Section 218 Agreement. In other cases, workers may be defined as “statutory employees” or “statutory nonemployees” because specific laws address the occupation (see [Publication 15-A](#) for more information on these workers). In general, however, the determination of worker status is made by applying an established common-law standard that addresses the facts and circumstances concerning how the work is performed. Whether workers are employees has significant consequences for tax liability and reporting.

Generally, when workers are employees, the government entity that employs them must withhold and pay employment taxes and file employment tax returns. Employment taxes consist of federal income tax withholding, Old-Age, Survivors and Disability Insurance (OASDI or Social Security) tax and the Hospital Insurance (Medicare) tax. The Social Security and Medicare tax make up the Federal Insurance Contributions Act (FICA) contributions, which are paid through employer and employee shares. State and local governments generally pay the Social Security tax on employees covered under Section 218 Agreements and on employees not covered by a public retirement system (mandatory coverage), and generally pay the Medicare portion on all employees hired after March 31, 1986. Wages paid by state and local governments are not subject to taxes under the Federal Unemployment Tax Act (FUTA), but state unemployment taxes may apply.

When workers are independent contractors, the governmental entity may have information-reporting and backup withholding responsibilities, but it is not required to withhold and pay employment taxes on behalf of those workers.

This chapter deals with the general rules for determining whether workers are employees, and the laws that apply to different categories of public employment.

## Workers Covered Under Section 218 Agreements

As discussed in [Chapter 1](#), states can enter into agreements with SSA to provide Social Security and Medicare coverage for their employees pursuant to Section 218 of the Social Security Act (Section 218 Agreements). If a position is covered by a Section 218 Agreement, then anyone holding that position is an employee. Therefore, the first question for a government to ask about a worker’s status is whether the worker is in a position covered under a Section 218 Agreement. If Section 218 Agreement coverage applies, this fact takes precedence over other considerations, including the common law tests discussed below and the mandatory coverage rules.

If you aren’t sure whether the Section 218 Agreement covers a specific position, contact your State Social Security Administrator (see [NCSSA](#) for a listing by state), or the [SSA Regional Office](#) for assistance. If a group of workers is covered under a Section 218 Agreement, the Agreement cannot be terminated or modified to exclude that coverage group.

Employees who are not covered under a Section 218 Agreement are generally subject to Social Security and Medicare unless they participate in a public retirement system that serves as a FICA replacement plan, discussed in [Chapter 6](#). However, Medicare taxes generally apply to wages of all state and local government employees hired after March 31, 1986. See [Chapter 5](#) for further information.

See IRC Section 7871 for information on the treatment of Indian tribes as governments. Indian tribal governments are not treated as states for purposes of Section 218. However, the [Tribal Social Security Fairness Act of 2018](#) provides information about Indian tribes wishing to offer Social Security coverage to tribal council members under Section 218A of the Social Security Act. For more information about Social Security coverage, Medicare and tribal governments, see the IRS Indian Tribal Governments [website](#).

## Common-Law Standard - Employee for Employment Taxes (FICA and Income Tax Withholding)

For employment tax purposes, an employee is defined by IRC Section 3121(d)(2) as “any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.” The common law test 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. In other words, does the entity have the right to tell the worker not only what will be done, but how it will be done? See Treas. Reg. Sections 31.3121(d)-1(c)(1) and 31.3401(c)-1(a).

In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories:

1. **Behavioral:** Does the company control or have the right to control what the worker does and how the worker does their job?
2. **Financial:** Are the business aspects of the worker’s job controlled by the payer? (These include things like how the worker is paid, whether expenses are reimbursed, who provides tools/supplies, and so on.)
3. **Type of Relationship:** Are there written contracts or employee type benefits (for example, retirement plan, insurance, vacation pay)? Will the relationship continue and is the work performed a key aspect of the business?

All these factors must be weighed when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. There is no “magic” or set number of factors that “makes” the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors that are relevant in one situation may not be relevant in another.

The keys are to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document each of the factors used in coming up with the determination.

### Behavioral Control

Facts that fall under this category show whether the entity has a right to direct and control how the worker performs the specific task for which they are engaged. Many times, when workers perform their tasks satisfactorily, the entity does not appear to exercise much control. The critical question, however, is whether there is a **right to control**. If the entity has the right to do so, it isn’t necessary that it actually direct and control the manner in which the services are performed.

The following considerations address the elements of behavioral control with respect to government employees:

<b>Instructions, Training and Required Procedures</b>	An employee is generally subject to the government entity’s instructions about when, where, and how to work. The employer has established policies, which the workers are required to learn and follow. Daily or ongoing instructions about the expected tasks are especially indicative of employee status. Training is a classic means of explaining detailed methods and procedures to be used in performing a task. Periodic or ongoing training about procedures to be followed and methods to be used indicates that the employer wants the services performed in a particular manner. This type of training is strong evidence of an employer-employee relationship. For instance, police officers and firefighters must be trained to comply with departmental rules and regulations. They don’t have the independence characteristic of independent contractors. Other examples of training that indicates employment include a state statute requiring that animal control officers receive state-sponsored training and a statute requiring that inspectors of sanitary facilities be trained and state-certified. These facts are indicative of a right to control. Election workers are trained to follow uniform procedures established for the polling place. They are directed by a supervisor.
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These facts suggest they would typically be employees. Government employees often work subject to regulations and manuals, which specify how their jobs are to be done. Teachers are required to receive periodic training in departmental policies. They are required to attend meetings, to follow an established curriculum, to use certain textbooks, to submit lesson plans and to abide by departmental policies concerning professional conduct. However, some types of training or minimal instructions may be provided to either an employee or an independent contractor, including orientation or information sessions about a government entity's policies and voluntary programs for which there is no compensation.

**Government Identification**

Government workers may be required to identify themselves by wearing a uniform or driving a marked vehicle. When individuals represent themselves as agents of a government, that gives them an appearance of authority. Wearing a uniform, displaying government identification, or using forms and stationery that indicate one is representing a government are highly indicative of employee status.

**Nature of Occupation**

The nature of the worker's occupation affects the degree of direction and control necessary to determine worker status. Highly-trained professionals such as doctors, accountants, lawyers, engineers or computer specialists may require very little, if any, instruction on how to perform their specific services.

Attorneys, doctors and other professionals can, however, be employees. In such cases, the entity may not train the individuals or tell them how to practice their professions, but may retain other kinds of control, such as requiring work to be done at government offices, controlling scheduling, holidays, vacations and other conditions of employment. Again, the government entity should consult state statutes to determine whether a professional position is statutorily created. On the other hand, professionals can be engaged in an independent trade, business or profession in which they offer their services to the public, including work for government entities. In this case, they may be independent contractors and not employees. In analyzing the status of professional workers, evidence of control or autonomy with respect to the financial details is especially important, as is evidence concerning the relationship of the parties as discussed below.

**Evaluation Systems**

Evaluation systems are used by virtually all government entities to monitor the quality of work performed. This isn't necessarily an indication of employee status. In analyzing whether a government entity's evaluation system provides evidence of the right to control work performance, consider how the evaluation system may influence the workers' behavior in performing the details of the job. If there is a periodic, formal evaluation system that measures compliance with performance standards concerning the details, the system and its enforcement are evidence of control over the workers' behavior.

**Financial Control**

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

The following considerations address the elements of financial control:

**Method of Payment** The method of payment must be considered. An individual who is paid a contract price, regardless of what it costs to accomplish the job, has a genuine possibility of profit or loss and, therefore, would not generally be considered an employee. An individual who is paid by the hour, week or month is typically an employee. However, this is not always the case; for example, independent contractor attorneys usually bill by the hour. An individual who is paid by the unit of work, such as a court reporter, may or may not be an independent contractor, depending on the facts.

**Offering Services to the Public** Another factor favoring independent contractor status exists when the individual makes their services available to the public or a relevant segment of the market. Relevant questions that address this issue include:

- Does the individual advertise?
- Does the individual use a private business logo?
- Does the individual maintain a visible workplace?
- Does the individual work for more than one entity?

**Corporate Form of Business** If the individual is incorporated and observes corporate formalities associated with this status, this makes it unlikely that they are an employee of the government entity. (A corporate officer will be an employee of the corporation.) The mere fact of incorporation or use of a corporate name, however, does not transform an employee into an independent contractor. The corporation must serve an intended business function or purpose, or be engaged in business.

**Part-Time Status** The fact that workers work on a part-time or temporary basis, or work for more than one entity, does not make them independent contractors. A part-time, temporary or seasonal worker may be an employee or an independent contractor under the common-law rules.

## Relationship of the Parties

The third category used to determine worker status is evidence of the relationship between the parties, including how they view their relationship. The relationship of the parties is generally evidenced by examining the parties' agreements and actions with respect to each other, paying close attention to those facts that show not only how they perceive their relationship, but also how they represent their relationship to others.

For example, the intent of how the parties perceive their relationship may be expressed in a written contract. A written agreement describing the worker as an independent contractor is evidence of the parties' intent, and in situations where it is unclear whether a worker is an independent contractor or employee, the intent of the parties, as reflected in the contract, may resolve the issue.

However, 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. The substance of the relationship, not the label, governs the worker's status (Treas. Reg. 31.3121(d)-1(a)(3)). The following items may reflect the intent of the parties:

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

The following are other considerations in evaluating the elements involving the relationship of the parties:

**Discharge or Termination**

The circumstances under which a business and a worker can terminate their relationship have traditionally been considered useful evidence concerning the status of the worker. However, business practices and legal standards governing worker termination have changed since these general principles developed. Under a traditional analysis, a government entity's ability to terminate the work relationship at will, without penalty, provided a highly effective method to control the worker. The ability to fire at will is indicative of employee status. In the traditional independent contractor relationship, the government entity could terminate the relationship only if the worker failed to provide the intended product or service, thus indicating that the business did not have the right to control how the work was performed. In the current environment, however, a government entity rarely has complete flexibility in discharging employees. The reasons a government entity can terminate an employee may be limited by law, by contract, or by its own practices. Consequently, inability to freely discharge a worker, by itself, no longer constitutes persuasive evidence that the worker is an independent contractor.

**Termination of Contracts**

Historically, a worker's ability to terminate work at will was 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 traditionally tended to indicate an independent contractor relationship. Today, however, it is more common that independent contractors may enter short-term contracts for which nonperformance remedies are inappropriate, or may negotiate limits on their liability for nonperformance. For example, professionals, such as doctors and attorneys, are typically able to terminate their contractual relationship without penalty. Accordingly, the worker's protection from liability for terminating the relationship does not necessarily indicate employee status.

**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 itself, is less relevant in determining worker status. On the other hand, a government entity's ability to refuse payment for unsatisfactory work continues to be characteristic of an independent contractor relationship. Because the meaning of the right to discharge or terminate is so often unclear, and depends primarily on contract and labor law, these facts should be viewed with great caution.

**Permanency**

The permanency of the relationship between the worker and service recipient is somewhat relevant to determining whether there is an employer-employee relationship. If a worker is engaged with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence of intent to create an employment relationship. However, a long-term relationship may also exist between a government entity and an independent contractor. There may be a long-term contract, or contracts may be renewed regularly due to superior service, competitive costs or lack of alternative service providers. Part-time, seasonal or temporary workers may also be employees under the common law. The fact that workers do not have full-time, permanent status is irrelevant to their classification.

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

In difficult cases, the IRS can provide a determination as to whether a worker is an employee or an independent contractor. To obtain a determination from the IRS, file [Form SS-8](#). Either a governmental entity or a worker may submit Form SS-8. The IRS will acknowledge receipt of the form and will request information from the other party. If a contract has been executed between the worker and the entity, a copy of the contract should be submitted with Form SS-8. In some cases, the State Social Security Administrator may help determine whether the entity and position are covered by a Section 218 Agreement. The IRS will generally issue a formal determination to the entity and will send a copy to the worker.

**Note:** The SS-8 determination is not an examination. It does not reopen a closed examination or change the findings for years previously examined.

## Classification Issues Involving Government Employees

The following discussion addresses some special worker classification situations involving governmental employees.

### Elected Officials and Officers

Under IRC Section 3401(c), an officer, employee or elected official of a state or local government is an employee for income tax withholding purposes. Thus, by federal statute, public officers are specifically included within the term “employee” for income tax withholding purposes (and conversely are **not** “independent contractors” for income tax withholding purposes). Treas. Reg. 31.3401(c)-1(a) clarifies the officers or employees can either be elected or appointed.

For Social Security and Medicare purposes, elected officials (also referred to as individuals in elective positions) are subject to a degree of control that typically makes them employees under the common law, and therefore subject to these taxes. Elected officials are responsible to the public, which has the power to vote them out of office. Elected officials may also be subject to recall by the public or a superior official. Very few elected officials have sufficient independence to be considered independent contractors.

### Public Officer or Official

The term “public officer” refers to someone who has authority to exercise the power of the government and does so as an agent and employee of the government. The Internal Revenue Code does not define the term “public officer,” but Treas. Reg. Section 1402(c)-2(b), addressing self-employment tax, provides that holders of “public office” are not in a trade or business and are therefore not subject to self-employment tax. Rather, an individual recognized as a “public officer” is an employee.

An exception to this rule applies for certain public officials paid solely on a fee basis (see [Chapter 5](#)).

The Treas. Reg. give the following examples of positions that constitute “public office”:

- Governor
- Mayor
- Member of a legislature or elected representative (elective office)
- County commissioner
- State or local judge, or justice of the peace
- County or city attorney
- Marshal, sheriff, constable
- Registrar of deeds
- Tax collector or tax assessor
- Road commissioners
- Members of boards and commissions, such as school boards, utility districts, zoning boards and boards of health

It may not always be clear whether a worker holds public office. In *Metcalf & Eddy v. Mitchell*, 269 U.S. 514 (1926), the U.S. Supreme Court addressed the definition of an officer. The Court ruled that an office is a public station conferred by the appointment of a government. The term “officer” includes the idea of tenure, duration, emolument and duties fixed by law, and where an office is created, the law usually determines its term, duties and compensation. In *Buckley v. Valeo*, 424 U.S. 1 (1975), the Supreme Court stated that anyone who exercises significant authority pursuant to the laws of the United States is an officer. The term “officers” embraces all appointed officials exercising responsibility under the public laws of the nation. Officers perform a significant governmental duty exercised pursuant to a public law and administer and enforce the public law.

If there is some question as to whether a worker is a public officer and employee, a critical factor to consider is whether there is a provision of the state constitution or a statute establishing the position. State statutes should be reviewed to determine whether they establish enough control for the individual to be classified as an employee under the common-law test. A statute may state that a specific position is that of a public official, in which case there is likely to be a right to control sufficient to make the individual an employee. Statutes may also specify the duties of a public office and generally establish the officer’s superiors and subordinates, if any. Statutes establish an official’s term of office and sometimes the compensation. They may require that a public official take an oath of office. Statutes often establish general and specific penalties for dereliction of duty. For instance, members of boards who are paid for each meeting they attend may face termination if they fail to attend a certain number of meetings.

**Example:** State A establishes the position of city attorney by statute and indicates that the position holder is an officer and an employee. This statute defines the duties of the position. The city attorney is required to direct all litigation in which the city is a party, including prosecution of criminal cases; to represent the city in all legal matters in which the city or a city officer is a party; to attend meetings of the commissioners, advise commissioners, mayors, and so on on all legal questions; and approve all contracts and legal documents. A city manager appoints, supervises and controls the work of the city attorney. The city attorney must take an oath of office. These facts show the importance of state statutes in establishing a right of direction and control over a public official and thus classifying the individual as a common-law employee.

## Home Care Service Recipients

A home care service recipient (HCSR) is an individual who receives home care services while enrolled in a program administered by a federal, state or local government agency that provides funding for that individual’s home care services. Home care services include health care and personal attendant care services rendered to the HCSR. Generally, the HCSR is considered the employer of the service provider under the common-law rules. The provision of home care services generally constitutes household employment.

The HCSR may request that the IRS authorize, under Section 3504, an agent to act on their behalf to withhold, report and pay the federal employment taxes for the workers who provide home care services. See [Revenue Procedure 2013-39](#) and [Form 2678](#), Employer/Payer Appointment of Agent. Special rules apply when a state or local government agency acts as the Section 3504 agent. A state or local government agency acting as a Section 3504 agent on behalf of an HCSR files an aggregate Form 941 and aggregate Form 940, attaching Schedule R (Form 941), Allocation Schedule for Aggregate Form 941 Filers, and Schedule R (Form 940), Allocation Schedule for Aggregate Form 940 Filers. Agencies must have an employer identification number separate from the one used to report taxes of its own employees for this purpose. The state agent may engage a reporting agent or subagent to perform the reporting and payment of employment taxes that the state agent would otherwise perform on behalf of the service recipient.

## Volunteer Firefighters

Compensation paid in an employer-employee relationship is taxable wages (unless an exclusion applies), regardless of whether the workers are termed “volunteers.” In some cases, rather than receive salaries, firefighters may receive amounts intended to reimburse them for expenses. They may also receive other cash or in-kind benefits that may be wages. Unless these reimbursements are paid under an accountable plan, discussed in [Chapter 3](#), these reimbursements are taxable as wages.

Amounts that are termed “reimbursements” but are not paid under an accountable plan are treated as wages and subject to income, Social Security and Medicare taxes.

Therefore, a per diem or fixed amount paid to a firefighter (or other worker), that does not reimburse actual, documented expenses, is includible in income and subject to income tax withholding, Social Security and Medicare.

The services of volunteers are generally not eligible for the exclusion from FICA for emergency workers, discussed in [Chapter 5](#). IRC Section 3121(b)(7)(F)(iii) provides that services performed by employees on a temporary basis in the case of fire, storm, snow, earthquake, flood or other similar emergency are exempt from employment. Firefighters who are on call and work part-time or intermittently do not qualify for the emergency worker exclusion. This exception applies only for temporary workers who are hired because of an unforeseen emergency.

## **Medical Residents**

Medical residents are generally common-law employees of the hospitals for which they work, and therefore are subject to Social Security and Medicare taxes (unless they are excepted by a Section 218 Agreement). IRC Section 3121(b)(10) provides an exception for students employed by a school, college or university (SCU) who are enrolled and regularly attending classes at the SCU. However, this exception is not available to full-time employees. Under Treas. Reg. Section 31.3121(b)(10)-2(d)(3)(iii), an employee whose normal work schedule is 40 hours or more per week is always considered a full-time employee. Therefore, medical residents generally do not qualify to exclude payments for their services from Social Security and Medicare taxes.

## **Identity of the Employer for Tax Purposes**

In certain cases, it is clear that the work in question is performed by employees, but it may not be clear which of two or more entities, organizations or individuals is the employer. This situation may arise when workers are supplied or paid by one entity but work under the direction of another (for example, leased workers).

The term “employer” is defined in IRC Section 3401(d), for income tax withholding and reporting purposes, as the person for whom an individual performs any service, of whatever nature, as an employee. However, an exception is provided if the person for whom the individual performs the services does not have control of the payment of the wages. In this situation, the term “employer” means the person having legal control of the payment of the wages except for purposes of the definition of wages under Section 3401(a) (IRC Section 3401(d)(1) and Treas. Reg. Section 31.3401(d)-1(f)). In the situation where there is an employer under Section 3401(d)(1), there are three parties for employment tax purposes: (1) the employee, (2) the employer under Section 3401(d)(1) (also known as a Section 3401(d)(1) employer) and (3) the employer under the common law rules (the common law employer).

When a question is raised about the identity of the employer, all facts relating to the employment must be considered. If there is any provision in a statute or ordinance that authorizes the employment by a government entity of the individual, and the individual is hired under this authority, the individual is generally an employee under the common law rules of that governmental entity. Any statutory provisions relating to the relationship should be reviewed. If there is no statutory authority, the identity of the employer must be determined under the common law control test.

If an entity is a Section 3401(d)(1) employer with respect to payments of wages to an employee, that employer under Section 3401(d)(1) is liable for the payment of employment taxes on the wages. However, the determination of whether the remuneration paid the employee is wages under Section 3121(a) for Social Security or Medicare purposes and wages under Section 3401(a) for income tax withholding purposes is made with respect to the common law employer. Thus, for example, a Section 3401(d) employer who is paying wages to employees on behalf of two or more common law employers cannot aggregate employees’ wages for purposes of calculating the wage base for taxes under FICA and FUTA. See *Cencast Services, L.P. v. United States*, 729 F.3d 1352 (Fed. Cir. 2013).

## Employee Status for Other Purposes

A state or federal agency may make determinations of employee status for workers' compensation, minimum wage or other purposes. The state or federal agency may apply different standards from those used to determine worker classification for federal employment tax purposes. Characterizations of individuals as employees based on state or non-tax laws should be weighed with caution, and in some cases disregarded, because the laws or regulations involved may use different definitions of an employee for their purposes.

## Independent Contractor Reporting Responsibilities

Independent contractors are subject to the taxes imposed under the Self-Employment Contributions Act (SECA). Taxes imposed under the SECA are usually referred to as self-employment tax, or SECA tax, to distinguish from the Social Security taxes and Medicare taxes under the FICA that apply in the case of employment. Generally, payments to independent contractors of \$600 or more during a calendar year must be reported on Form 1099-NEC. Independent contractors are required to provide a taxpayer identification number to the entity that pays them. [Form W-9](#) contains the required certification and can be used for this purpose.

For more information about requirements for information reporting to independent contractors, see the [Instructions for Form 1099-MISC and 1099-NEC](#). Workers who have been treated as independent contractors but are later determined to be employees will need to file amended returns if they reported income on Form 1040, Schedule C, and calculated self-employment tax (SECA) on Schedule SE. A worker in this situation should use [Form 8919](#), Uncollected Social Security and Medicare Tax on Wages, to figure and report the employee share of Social Security and Medicare taxes imposed under the FICA. Entities that misclassify employees as independent contractors may be held liable for back taxes, penalties and interest.

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

Individuals who are employees for some services may not be employees for other services they provide. For example, a teacher may be retained to remove snow from school property. This individual may be an employee as a teacher but an independent contractor for the snow-removal activity. Apply the common law rules separately to each activity to establish whether it is an independent trade or business.

Revenue Ruling 58-505 explains that for an individual to work in two capacities (employee and contractor), the services must not be interrelated. Stated differently, an individual does not work in two capacities when the same type of work, such as legal services, is divided into two components, one in an employee capacity and one in an independent contractor capacity. The services and remuneration for the two activities must be separate.

## Section 530 Relief

State and local government entities under examination by the IRS may be entitled to relief from employment tax for certain workers under Section 530 of the Revenue Act of 1978 (Section 530). If applicable, Section 530 terminates an entity's federal employment taxes, including Social Security and Medicare, income tax withholding and any penalties attributable to the liability. See [Revenue Procedure 85-18](#). This relief is not available for services covered by a Section 218 Agreement.

If the requirements for Section 530 relief are met, but the services are covered by a Section 218 Agreement, the entity may obtain relief from liability for income tax withholding for prior years. However, Section 530 relief from income tax withholding will not apply with respect to wages paid after the date on which the entity is advised that the workers are covered under a Section 218 Agreement. This is because the entity would have begun withholding FICA taxes, which constitutes treatment of the workers as employees. See [Revenue Procedure 85-18](#), section 3.03(C) and 3.04.

Section 530 provides relief for an entity that treated workers as nonemployees if the entity had a reasonable basis for the classification and acted consistently on that basis. To qualify for Section 530 relief, the entity must have a reasonable basis for treating the worker as an independent contractor. Section 530 provides three safe harbors for satisfying the reasonable basis requirement:

1. Published ruling or judicial precedent;
2. Prior IRS examination of the taxpayer (if after 1996, the examination must have included a review of worker classification); or
3. Longstanding recognized practice of a significant segment of the industry. Alternatively, an entity may establish some other reasonable basis. For more information, see [Revenue Procedure 85-18](#).

In addition, the entity must:

1. Have filed all federal tax returns (including information returns) on a basis consistent with treatment of the worker as a nonemployee; and
2. Not have treated the worker, or any other worker in a substantially similar position, as an employee.

For more information about the requirements for Section 530 relief, see [Publication 1976](#), Do You Qualify for Relief Under Section 530?

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

## Tax Consequences for Workers

In some cases, a government entity may be entitled to relief under Section 530, but workers find, through a determination letter or some other means, that they have been misclassified and are employees under the common law. Section 530 does not extend employment tax liability relief to workers. It does not convert them from employees to independent contractors. Misclassified employees remain liable for the employee share of Social Security and Medicare taxes rather than for SECA (self-employment) tax. (See [Form 8919](#) for this computation.) If the workers have been filing income tax returns as independent contractors, they should file amended returns for years for which the statute of limitations is open. As employees, they are not entitled to deduct unreimbursed business expenses on [Schedule C](#). Because these Section 530 relieved employers are entitled to continue treating these workers as independent contractors, the workers will not be subject to income tax, Social Security or Medicare withholding and will generally have to make estimated tax payments to cover their tax liabilities. Information provided in [Notice 989](#), Commonly Asked Questions When IRS Determines Your Work Status is “Employee,” although not written specifically to Section 530 employees, provides information for filing their income tax returns or amended returns. Please note, however, that not all references of Notice 989 are applicable, for example, the Section 530 employer will not be liable to provide a corrected Form W-2 in in this situation.

## Frequently Asked Questions

### 1. What are the consequences of misclassifying a worker?

Generally, when an employer erroneously classifies an employee as an independent contractor and does not withhold federal payroll taxes, the employer is liable for the employer and employee shares of all applicable federal payroll taxes, as well as penalties and interest. [IRS]

### 2. What do you do if you cannot determine whether a worker is an employee?

The state or local entity or the worker can request a formal determination by submitting to the IRS [Form SS-8](#), Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding. The IRS will review the facts and circumstances and officially determine the worker’s status. [IRS]

### 3. Are volunteers considered employees?

The common law tests apply to determining the status of individuals regardless of whether they are deemed “volunteers.” If an individual considered a volunteer meets the common law tests, any form of compensation or benefit they receive is considered wages, unless a specific exception applies. [IRS]

### 4. What effect does the presence of a Section 218 Agreement have on worker status?

If an existing Section 218 Agreement classifies a position as that of an employee covered by the Agreement then an individual in that position is an employee, subject to FICA and income tax withholding; the common law tests are not considered. Positions not covered by a Section 218 Agreement should be evaluated under the common law tests. [SSA/IRS]



## ■ Chapter 5

# Social Security and Medicare Coverage

As discussed in [Chapter 3](#), cash or noncash compensation for services is subject to income, Social Security and Medicare taxes unless certain exceptions apply. In addition, state and local employees may be exempted from Social Security (and in some cases, Medicare) taxes based on coverage under a public retirement system. A public employee may be covered for Social Security and Medicare, Medicare only, or may be exempt from both. The flowchart in [Chapter 1](#), illustrates the process for determining the Social Security and Medicare coverage that applies to an employee. This chapter addresses various categories of employees and rules by which coverage is established, including the process for obtaining coverage under a Section 218 Agreement. As a supplement to the Social Security coverage information provided in this publication, refer to the SSA [State and Local Government Employers page](#). Additional information is also available at [IRS.gov/FSLG](https://www.irs.gov/FSLG).

All state and local government employees fall into one of three categories with respect to Social Security:

- 1. Section 218 Agreement coverage (also called voluntary coverage).** These employees are covered for Social Security by a voluntary (coverage is requested by the state) Section 218 Agreement between the state and the SSA. They may or may not participate in a public retirement system.
- 2. Mandatory Social Security coverage.** After July 1, 1991, employees are required to be covered for amounts deemed to be wages unless they are covered by a Section 218 Agreement or are members of a qualifying public retirement system.
- 3. No Social Security coverage.** These employees are not covered by a Section 218 Agreement but are covered by a qualifying public retirement system and, therefore, exempt from mandatory Social Security.

Each of the three categories of employees is discussed below.

## Employees Under Section 218 Agreement Coverage

State and local government employees can be covered for Social Security and Medicare through a Section 218 Agreement between the state and the SSA. This agreement may provide coverage for any of the following:

- Groups of employees in positions covered by a retirement system.
- Groups of employees in positions not covered by a retirement system.
- Employees in positions that are excluded from mandatory coverage provisions but are optional exclusions under Section 218 Agreements (for example, student services).
- Medicare Hospital Insurance (HI)-only coverage 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. Only the State Social Security Administrator can initiate a request for Section 218 Agreement coverage on behalf of an entity in the state. Additional coverage can be provided by modifications. Each modification, like the original agreement, is binding on all parties.

To establish an agreement, authority must exist under state law (state enabling legislation) to enter into an agreement and to extend coverage under an agreement. The types and extent of coverage provided under an agreement must be consistent with federal and state laws.

State and local government employees who are covered under an agreement have the same benefits, rights and responsibilities as employees who have mandatory Social Security coverage. The cost to the employer of providing Social Security protection for state and local government employees is the same as that for employees in mandatory coverage.

Coverage under an agreement must be provided for groups of employees. An agreement may be modified to increase, but not to decrease, the extent of coverage. (An exception applies to election worker services and solely fee-based positions; see **Optional Section 218 Exclusions**, below.)

The effective date of coverage is the date specified by the state for coverage to begin. See [SL 30001.375: Effective Dates of Coverage](#).

**Important:** The Internal Revenue Code limits the statutory period of assessment and collection of taxes to the three-year period after the tax return for a particular year was filed. This can come into conflict with SSA's Section 218 effective date of retroactivity when a state or local government seeks a retroactive modification to a Section 218 agreement covering a five-year period. Thus, SSA can only process and approve any modification to a Section 218 Agreement requesting a period of coverage in excess of the three years beyond the statutory period for FICA tax collection if the taxpayer agrees that it will execute a closing agreement with the IRS. See [SL 40001.420: Modifications to the Agreement](#) for more information on closing agreements.

## Termination of Agreements

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

## Coverage Groups

Coverage under Section 218 Agreements can be extended only to groups of employees, referred to as coverage groups. Once an employee position is covered under a Section 218 Agreement, any employee filling that position is a member of the coverage group for Social Security and Medicare. There are two types of coverage groups: (1) an absolute or non-retirement coverage group (employees not in a retirement system) and (2) a retirement system coverage group. Each state decides, within federal and state law, which groups to include under its agreement and when their coverage begins. The state can choose to cover non-retirement system groups, retirement system groups or both.

### Absolute Coverage Groups (Non-Retirement System Groups)

An absolute coverage group includes the services of employees in positions not covered by a retirement system, except those whose services are mandatorily or optionally excluded from Social Security and Medicare coverage. They may also be referred to as non-retirement system groups or Section 218(b)(5) groups. A state may extend Section 218 Agreement coverage to an absolute retirement system group without considering the desires of the employees. An absolute coverage group may consist of any of the following:

- All employees of a state engaged in performing services in connection with governmental (nonproprietary) functions
- All employees of a state engaged in performing services in connection with a single proprietary (other than governmental in nature) function
- All employees of a political subdivision of a state engaged in performing services in connection with governmental (nonproprietary) functions
- All employees of a political subdivision of a state engaged in performing services in connection with a single proprietary (other than governmental in nature) function
- Certain civilian employees working with the National Guard of a state
- Individuals employed under an agreement between a state and the United States to perform services as inspectors of agricultural products

## **Retirement System Coverage Group**

A retirement system coverage group consists of employees working in positions covered by a public retirement system (also called a FICA replacement plan), as provided in Section 218(d)(4) of the Social Security Act (Act). This group may be provided Social Security and Medicare coverage under an agreement only if approved by a referendum. The Act gives the state the option, for referendum purposes, of breaking down a retirement system into its components. If a retirement system covers positions of employees of one or more political subdivisions of the state, the state may hold a referendum for:

1. All employees in positions under the retirement system,
2. State employees in positions under the system,
3. Employees of one or more political subdivisions in positions under the system,
4. Any combination of the groups in 2 and 3,
5. Employees of a hospital that is an integral part of a political subdivision,
6. Employees of two or more hospitals (each hospital must be an integral part of the same political subdivision), or
7. Employees of each institution of higher learning.

The referendum for retirement system employees is conducted either on a majority vote basis (allowed in all states) or on a divided system basis (allowed in certain states).

### ***Majority Vote Referendum***

Under this type of referendum, Social Security and Medicare 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 the coverage. A majority of all the eligible employees under the system (not a majority of the eligible employees casting votes) must vote in favor of coverage. All states are authorized by federal law to use the majority vote referendum procedures. Although the referendum itself is a state matter, federal law requires that the following conditions be met to establish coverage:

1. Eligible employees are given not less than 90 days notice of the referendum
2. An opportunity to vote is given and limited to eligible employees who were in an employment relationship with the employer both on the date the notice was given and on the date the referendum is held
3. The referendum is held by secret ballot
4. The referendum is supervised by the governor (or designee)
5. A majority of the retirement system's eligible employees vote for coverage

### ***Divided System Retirement Referendum***

In addition to the majority vote referendum procedure, certain states and all interstate instrumentalities are authorized to divide a retirement system based on whether the employees in positions under the retirement system want coverage. Under the divided vote referendum, only those employees who vote "yes" and all future employees who become members of the retirement system will be covered. Members who vote "no" are not covered as long as they maintain continuous employment in a position within the same public retirement system coverage group.

The states having this authority under Section 218(d)(6)(c) of the Act are:

<b>Alaska</b>	<b>Illinois</b>	<b>New Jersey</b>	<b>Tennessee</b>
<b>California</b>	<b>Kentucky</b>	<b>New Mexico</b>	<b>Texas</b>
<b>Connecticut</b>	<b>Louisiana</b>	<b>New York</b>	<b>Vermont</b>
<b>Florida</b>	<b>Massachusetts</b>	<b>North Dakota</b>	<b>Washington</b>
<b>Georgia</b>	<b>Minnesota</b>	<b>Pennsylvania</b>	<b>Wisconsin</b>
<b>Hawaii</b>	<b>Nevada</b>	<b>Rhode Island</b>	

These “divided vote” states may choose between a divided system vote and a majority vote referendum.

States authorized to use the divided vote retirement system referendum to extend coverage may use either of two voting procedures:

1. **Simplified One-Step Method:** Poll all eligible members and divide the system into two parts, with each member placed in either the “Yes” or “No” group based on their choice (simplified one-step referendum), or
2. **Original Two-Step Method:** Subdivide the retirement system into two parts or systems – “Yes” and “No” groups – based on each individual member’s choice and then, after the individuals are separated based on this preference, conduct a majority vote referendum among the “Yes” group. These individuals can then change their original poll vote.

The conditions for a divided vote referendum are the same as those given for the majority vote referendum with two exceptions: (1) the ballots are not secret because the individuals choosing coverage must be identified and (2) the individual must be in an employment relationship and a member of the retirement system when the vote is held (but not necessarily when the referendum notice was given).

At the discretion of the state, employees who become members of the retirement system after the referendum (division) date and before the execution of the modification extending coverage to the retirement system coverage group may be given a choice to receive coverage.

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

## Continuation of Coverage Rules

Once coverage is provided for state and local government employees, it generally continues unless an event occurs that results in termination of the coverage, such as a change in employer. The continuation rules are applied for each type of coverage group as follows:

**Absolute Coverage Group:** Social Security and Medicare coverage for non-retirement system groups continues as long as the continuing governmental entity exists. This is true even if the positions are later placed under a retirement system. (This provision includes police and firefighter positions that were first covered as an absolute coverage group.)

**Majority Vote Retirement System Group:** Following a favorable majority vote referendum, services under the retirement system, including positions brought under the retirement system in the future, are compulsorily covered for Social Security under the state’s Section 218 Agreement. Social Security and Medicare coverage will continue as long as the continuing governmental entity exists, even though the positions are later removed from under the retirement system, the system is abolished or the positions are placed under an additional retirement system.

**Divided Vote Retirement System Group:** If the use of the original two-step referendum results in a favorable majority, then the entire “Yes” group **and** all future members of the retirement system are covered.

As a result of the simplified one-step referendum all those retirement system members who voted “Yes” and all future retirement system members are covered for Social Security. If all current retirement system members vote against Social Security coverage (the “No” group), then only future retirement system members will be covered for Social Security and make up the “Yes” group.

Under a divided retirement system, employees carry the “No” or “Yes” vote with them if they transfer to another position within the same retirement system coverage group.

Social Security coverage is not terminated because the positions are later covered under an additional retirement system.

If the divided vote retirement system is later abolished or positions are removed from coverage under it, the “Yes” group (those employees who voted “Yes” in the referendum and those subsequently hired retirement system members) continue to be covered for Social Security. New employees hired into positions after the removal from, or abolishment of, the former

retirement system, are not covered for Social Security because they would not be considered new members of that former retirement system.

## Section 218 Coverage Exclusions

When a state or local government entity voluntarily enters into the state's Section 218 Agreement with the SSA, it's important to determine which employee services will be excluded from Social Security coverage. If services are excluded, any employees performing these services are not covered by the agreement.

Certain services – known as **required exclusions** – are excluded from voluntary Social Security coverage by Section 218(c)(6) of the Act.

Other services, however, are **optional exclusions** under Sections 218(c)(3), (5) and (8) and, therefore, may be covered under a voluntary Section 218 Agreement. Coverage under a Section 218 Agreement supersedes all other considerations. If optional exclusion services are covered under a Section 218 Agreement, these amounts are subject to Social Security and Medicare tax.

### Required Section 218 Exclusions

Federal law requires the exclusion of the following services from Section 218 coverage under Section 218(c)(6) of the Act:

- **Services performed by individuals hired to be relieved from unemployment.** The intent of the program establishes whether the program is designed to relieve individuals from unemployment. This is usually determined from the statutes or other authorities that established the program. The exclusion does not include services performed by individuals under programs, such as work-study, where the primary purpose is to provide work experience and training to increase the employability of the person, because the primary intent of the programs is not to relieve them from unemployment.
- **Services performed in a hospital, home or other institution by a patient or inmate thereof as an employee of a state or local government.** Generally, these services are performed by individuals who are not normally in an employment relationship with the state or political subdivision. In the case of work performed by inmates in a state prison or local jail, they are excluded from coverage, whether or not the services are performed outside the confines of the prison or jail, because in either case the inmates are normally not in an employment relationship with the state or political subdivision. However, services performed by inmates outside the prison or jail for an entity other than the state or local government operating the prison or jail, such as on a work-release program, may be covered if an employment relationship exists. The employer for tax purposes is determined under the common-law rules, discussed in [Chapter 4](#). **Note:** Services performed by patients or inmates as part of the rehabilitative or therapeutic program of the institution are not usually considered to be services performed by employees.
- **Covered transportation service.** This includes services performed by transportation system employees who are covered for Social Security under Section 210(k) of the Social Security Act.
- **Other services that would be excluded if performed for a private employer because the work is not defined as employment under Section 210(a) of the Social Security Act.** This includes services performed by a nonresident alien temporarily residing in the U.S. holding an F-1, J-1, M-1 or Q-1 visa, when the services are performed to carry out the purpose for which the alien was admitted to the U.S. (A state may optionally include certain agricultural services under a Section 218 Agreement.) See [Foreign Students, Teachers and Apprentices](#).
- **Services performed by an employee hired temporarily in case of fire, storm, snow, earthquake, flood or similar emergency.** This exclusion applies only to those who are hired on a temporary basis in response to a specific emergency. It doesn't include workers considered temporary for other reasons or individuals in a continuous employment relationship who perform services related to emergencies on a regular or continuing basis.
- **Service described in Section 210(a)(7)(F) of the Social Security Act that is included as "employment" under Section 210(a).** Services by individuals not covered by a public retirement system and subject to mandatory coverage are excluded from coverage under a Section 218 Agreement.

**Caution:** Required exclusions apply to **voluntary** Social Security coverage situations (through a Section 218 Agreement) and should not be confused with the different set of exclusions that applies to **mandatory** Social Security coverage situations.

## Optional Section 218 Exclusions

Under a Section 218 Agreement, a state has the option to exclude from Social Security coverage the services listed below when they are performed by members of any coverage group, including retirement system coverage groups. If the agreement does not specifically exclude these services, they are covered.

The following are positions and services that may be excluded at the option of the state:

- **All services in any class or classes of elective positions.** These are positions filled by an election; they also may be referred to as “elected officials.” The election may be by a legislative body, a board or committee, or by the qualified electorate of a jurisdiction. The method of selection must constitute an election under state law. The election may be conducted through open voting by the electorate at large, or by a chosen body from a list of candidates. Generally, elective positions fall into three classes: executive, legislative and judicial.
- **All services in any class or classes of part-time positions.** A part-time position is one for which the number of work hours normally required by the position in a week or a pay period is less than the normal time requirements for the majority of the positions in the employing entity. The part-time position exclusion is based on the normal time requirements of the position and not the time spent by an employee in the position. If a position is established as a full-time position, but the employee works part-time in this position, the exclusion does not apply. Conversely, if a position is established as a part-time position and the employee works full-time in this position, the services of the employee are excluded. Whether seasonal or temporary positions that require full-time services for a period of short duration are part-time positions depends on the definition of part-time established for the coverage group. Where the part-time position exclusion is taken, the state should include a definition of “part-time” in the modification if one has not been previously established.

**Note:** The definition of “part-time” under Section 218 Agreement provisions may be different from the definition of “part-time” used to determine whether an individual is a qualified participant in a public retirement system (discussed in [Chapter 6](#)).

**Example:** A city provides Social Security coverage to some of its employees under a Section 218 Agreement, but excludes services performed in part-time positions. The Section 218 Agreement defines part-time positions as positions normally requiring less than 50 hours of service per month. The city must apply the definition in the Section 218 Agreement to determine which employees are excluded from Social Security coverage under the agreement. Any employees excluded from coverage under the agreement may then be subject to mandatory coverage.

- **Fee-based public officials services in any class or classes of positions compensated solely by fees received directly from the public, by an individual who is treated by the municipality as self-employed.** See [Fee-Based Public Officials](#).
- **Agricultural labor, but only those services that would be excluded if performed for a private sector employer.** A state that initially excludes agricultural labor may later modify its agreement to cover it. However, if agricultural labor is not excluded initially, it cannot be excluded later. If a state has not taken the agricultural exclusion, then all remuneration for agricultural labor is covered for Social Security.
- **Services performed by students enrolled and regularly attending classes at the school, college or university for which they are working.** The student exclusion applies only during periods of regular school attendance, whether during the regular academic year or in summer session. The exclusion does not apply to work done during summer vacation if the student is not attending a summer session. Services performed by students during holidays, weekends, seasonal breaks and between semesters falling within the academic year when classes are not scheduled are excluded.
- **Services performed by election officials or election workers paid less than the calendar year threshold amount mandated by law.** (If the state’s Section 218 Agreement does not have an election-worker exclusion, or the entity has an agreement that does not exclude election workers, Social Security and Medicare taxes apply from the first dollar paid.) See [Election Officials and Election Workers](#).

**Note:** Effective July 2, 1991, elective and part-time positions, although optionally excluded under a Section 218 Agreement, must be covered under a qualifying public retirement system or else they will be covered for Social Security under the mandatory Social Security provisions.

Optional exclusions can be taken by the state in any combination and applied to both absolute and retirement system coverage groups. Any services a state excludes can be included later if permitted by federal and state law and the state's agreement. Generally, if one of the types of work listed above has been included in a coverage group, it cannot later be removed from coverage, except for services performed by election officials/workers and solely fee-based positions.

Optional exclusions apply only to voluntary Social Security coverage under a Section 218 Agreement; there are no optional exclusions from mandatory coverage.

**Note:** The 1972 Amendments to the Social Security Act allowed states a limited period to exclude services in part-time positions and services performed by students, in cases where this exclusion was not initially chosen. An additional window to make this election was provided by Public Law 105-277, enacted October 21, 1998, which allowed states a limited period to exclude the services of students employed by the public school, college or university where they are regularly attending classes. In those states exercising this option, the student exclusion was effective July 1, 2000. Where a state used either or both of these special one-time provisions for excluding services that had been covered previously, it cannot again cover these services under a Section 218 Agreement.

## **Employees Under Mandatory Social Security Coverage**

Public Law 101-508 mandated full Social Security coverage beginning July 2, 1991, for state and local government employees who are not members of a qualifying public retirement system (also called a FICA replacement plan) and who are not covered under a Section 218 Agreement, unless a specific exclusion applies under the law.

If an employee is mandatorily covered for Social Security, then becomes a member of a qualifying public retirement system, mandatory coverage ends; Social Security coverage would apply only if the position becomes covered by a Section 218 Agreement.

If an employee becomes a member of a public retirement system and is covered for Social Security under a Section 218 Agreement, the employee continues to be covered for Social Security and Medicare.

The determination of whether an employee is covered by mandatory Social Security is made individually. For example, a Section 218 Agreement may exclude part-time positions and a public retirement system may exclude part-time employees for the same entity. If an employee is excluded from Section 218 coverage because of work performed in a part-time position (as defined under the agreement) and is also excluded from membership in a public retirement system because of part-time status, that employee is subject to mandatory Social Security.

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

## **Exclusions from Mandatory Social Security Coverage**

Under Section 210(a) of the Social Security Act, the following categories of employees are not subject to mandatory Social Security coverage, even if they are not covered by a public retirement system:

- **Services performed by individuals hired to be relieved from unemployment.** The intent of the program establishes whether the program is designed to relieve individuals from unemployment. This is usually determined from the statutes or other authorities that established the program. The exclusion doesn't include services performed by individuals under programs, such as work-study, where the primary purpose is to provide work experience and training to increase the employability of the person, because the primary intent of the programs is not to relieve them from unemployment.
- **Services performed in a hospital, home or other institution by a patient or inmate thereof as an employee of a state or local government.** Generally, services performed by inmates in a state prison or local jail are excluded from coverage. This is true whether or not the services are performed outside the confines of the prison or jail, because the inmates are not normally in an employment relationship with the state or political subdivision. However, services performed by inmates outside the prison or jail for an entity other than the state or local

government operating the prison or jail, such as on a work-release program, may be covered if an employment relationship exists. The employer for tax purposes is determined under the common-law rules, discussed in [Chapter 4](#). **Note:** Services performed by patients or inmates as part of the rehabilitative or therapeutic program of the institution are generally not employment.

- **Services performed by an employee hired temporarily in case of fire, storm, snow, earthquake, flood or similar emergency.** This exclusion applies only to those workers who are hired on a temporary basis in response to a specific emergency. It doesn't include workers considered temporary for other reasons or individuals in a continuous employment relationship who perform services related to emergencies on a regular or continuing basis.
- **Services performed by election officials or election workers paid less than the calendar year threshold amount mandated by law, unless a Section 218 Agreement covers election workers.** See [Election Officials and Election Workers](#), below.
- **Services in positions compensated solely by fees that are subject to self-employment tax, unless a Section 218 Agreement covers these services.** See [Fee-Based Public Officials](#).
- **Services performed by a nonresident alien temporarily residing in the U.S. holding an F-1, J-1, M-1 or Q-1 visa, when the services are performed to carry out the purpose for which the individual was admitted to the U.S.** See [Foreign Students, Teachers and Apprentices](#).
- **Services performed by students enrolled and regularly attending classes at the school, college or university where they are working, unless a Section 218 Agreement covers student services.**
- **Services that would be excluded if performed for a private employer because the work is defined as employment under Section 210(a) of the Social Security Act, unless a Section 218 Agreement covers certain agricultural services.**

**Note:** Coverage under a Section 218 Agreement always takes precedence over other employment circumstances. When considering whether the mandatory Social Security coverage and exclusion rules apply to a worker's services, first determine whether the services are covered by a Section 218 Agreement.

## Election Officials and Election Workers

Prior to the Social Security Amendments of 1967, there was no specific provision for the exclusion of election officials or election workers. The Social Security Act was amended to allow states to modify their agreements to exclude the services of election officials and election workers whose pay was below an annually determined threshold amount.

The FICA tax exclusion for election officials and election workers is \$1,900 for the 2020 calendar year unless those wages are subject to Social Security and Medicare at a lower threshold under the state's Section 218 Agreement.

If the entity is covered by a Section 218 Agreement, the agreement determines the treatment of election workers for FICA purposes. The agreement may specify a lower threshold amount for election officials and election workers (for example, \$50 a calendar quarter or \$100 a calendar year). In these states, the Social Security and Medicare tax applies when the amount specified in the state's agreement is met. States may modify the agreement to exclude the services of election officials and election workers paid less than the threshold amount mandated by law. These modifications are effective in the calendar year the modification is mailed or delivered to the Social Security Administration.

If the Section 218 Agreement does not exclude election workers from coverage, or does not provide a threshold for coverage, Social Security and Medicare taxes apply from the first dollar paid. If the entity is not covered under a Section 218 Agreement, the rules for mandatory Social Security and Medicare under Section 210(a)(7)(F) of the Social Security Act apply.



Go to [SSA election workers](#) for the latest FICA tax exclusion for election officials and elections workers. The election official/worker thresholds under mandatory Social Security for calendar years prior to 2021 are:

2020	\$1,900
2017 – 2019	\$1,800
2016	\$1,700
2013 – 2015	\$1,600
2009 – 2012	\$1,500
2008	\$1,400
2006 – 2007	\$1,300
2002 – 2005	\$1,200
2000 – 2001	\$1,100
1995 – 1999	\$1,000
1978 – 1994	\$100

For calendar years 1968 through 1977, the threshold was \$50 per calendar quarter.

Generally, Form W-2 is required for these workers; however, if the worker received only wages for election work and the total is less than \$600 total for the year, Form W-2 is not required and no Social Security or Medicare tax withholding is required. The amount paid is includible in the gross income of the worker. [Revenue Ruling 2000-6](#) provides reporting procedures for payments to election officials and election workers in different situations.

Contact your State Social Security Administrator concerning the status of election officials and election workers under the state's Section 218 Agreement. Additional information and threshold amounts can be found at [SSA.gov](#).

### **Fee-Based Public Officials**

A fee-based public official receives and retains remuneration directly from the public. An individual who receives payment for services from government funds in the form of wages or salary is not a fee-based public official, even if the compensation is called a fee.

Beginning in 1968, services performed in positions compensated solely by fees are excluded from coverage under Section 218 Agreements unless the state specifically covers these services. If a state covered these positions before 1968, it may modify its agreement to exclude these positions prospectively. The exclusion is effective the first day of the year following the year in which the modification is mailed or delivered to SSA. If a state covered and later excluded these positions, the state cannot again cover these positions.

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

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

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

Generally, a position compensated by a salary and fees is considered a fee-basis position if the fees are the principal source of compensation, unless a state law provides that a position for which any salary is paid is not a fee-basis position.

If the state law does include this provision, none of the compensation, including the salary, is covered wages under the state's Section 218 Agreement. In this case, the salary payment, while excluded under the agreement, is subject to mandatory Social Security if the official is not a qualified participant in a public retirement system.

### **Police Officers and Firefighters**

Beginning August 16, 1994, **all** states were allowed to extend Section 218 Social Security and Medicare or Medicare-only coverage to police officer and firefighter positions covered under a retirement system through a referendum procedure

conducted by the state. (Prior to August 16, 1994, only 23 states, and all interstate instrumentalities, were specifically authorized by Congress to do so.) Those states were:

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

As noted earlier, all states may use the majority vote referendum procedure. Some states are also authorized under the Act to use the divided retirement system referendum, discussed earlier. (Interstate instrumentalities may use the majority or divided retirement system referendum procedures.) As with other retirement system employees, before referendums can be held and coverage extended to police officer and firefighter positions already covered by a retirement system, there must first be authority to provide the coverage under state law (state statutes and/or the enabling act) and the federal-state agreement (via a modification to the state's Section 218 Agreement).

Generally, state statutes and court decisions establish the definition of police officer and firefighter positions. For Social Security purposes, the terms do not include services in positions that, although connected with police and firefighting functions, do not meet the definitions of police officer and firefighter positions.

**Note:** Police officers and firefighters are **not** considered emergency workers for purposes of the mandatory exclusion from Social Security and Medicare coverage for these workers. This exclusion applies only to services of an employee who was hired because of an unforeseen emergency to do work in connection with that emergency on a temporary basis to provide emergency assistance in fires or other disasters such as severe ice storm, earthquake, volcano eruption or flood.

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

If police officer and firefighter positions are not covered under a retirement system, these positions are mandatorily covered for Social Security and Medicare unless the positions were already covered under a Section 218 Agreement as part of a non-retirement system (absolute) coverage group.

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

Individuals admitted to the United States under an F-1, J-1, M-1 or Q-1 visa are generally exempt from both Social Security and Medicare taxes. Wages earned within the United States are subject to income tax, whether or not the workers are U.S. citizens.

Nonresident students who are not U.S. citizens, permanent residents or resident aliens for tax purposes may be able to take advantage of treaty exemptions to exclude a portion of their U.S. source income from withholding. For more information on specific treaty provisions, contact the IRS or SSA. The following IRS publications have additional information on Social Security and Medicare coverage for foreign workers:

- [Publication 515](#), Withholding of Tax on Nonresident Aliens and Foreign Entities
- [Publication 519](#), U.S. Tax Guide for Aliens
- [Publication 901](#), U.S. Tax Treaties

### **Employees With No Social Security Coverage**

The final category of workers includes those who are not subject to any voluntary or mandatory Social Security coverage. This can only occur where the workers are covered by a FICA replacement plan and are not covered by a Section 218 Agreement. Employers of these workers will not withhold Social Security taxes or show any Social Security wages on Form W-2; they are generally covered for Medicare. Public retirement systems are the subject of [Chapter 6](#).

## Identifying Covered Employment

In addition to determining whether specific employees are members of a Social Security coverage group, questions may arise as to whether certain positions constitute employment. These determinations may be based on decisions regarding specific issues to which either federal or state law applies. It's 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 according to their state and local laws, regulations and the state court decisions. Jurisdiction for some of the major questions include:

### Federal Law:

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

### State Law:

- Who is an officer of a state or political subdivision?
- Is an entity a political subdivision?
- Is a function governmental (nonproprietary)?
- Is a function other than governmental in nature (proprietary)?
- Is a position under a retirement system?
- Which employees are eligible for membership in a retirement system?
- Who is an employee for purposes of retirement system participation?

Although federal law determines whether earnings are wages subject to Social Security and Medicare, state laws have a bearing on the issue of employment, such as whether a position is that of a public official of a state. Where this is the case, an opinion of the state legal officer may be requested. The state's opinion will be given weight in making the decision, but it will not be determinative of the issue. Before contacting IRS or SSA, contact the State Social Security Administrator for guidance.

The federal courts provide the ultimate determination of how Social Security and tax laws will apply in a given situation.

**Note:** Federal Circuit Court decisions are binding only in the circuit in which they are issued. For a map of federal Circuit Court jurisdictions, see the interactive map at [www.uscourts.gov/court\\_locator.aspx](http://www.uscourts.gov/court_locator.aspx).

## Identity of the Employer for Social Security Coverage Purposes

Because entities have different Social Security and retirement plan situations, it's important to determine which of two or more entities, organizations or individuals is the employer. In some cases, certain individuals, referred to as leased workers, are supplied or paid by one entity but work under the direction of another. Generally, if there is a provision in a statute or ordinance that creates a position and the individual is hired or elected under this authority, the individual is an employee of the state or political subdivision to which the provision applies. If there is no such authority, the employer is the entity that has the right to control the worker in the performance of the work, the common-law employer.

The employing entity is responsible for withholding and paying Social Security and Medicare taxes on its employees' wages, as well as reporting to SSA the amount of wages paid. These withholding, paying and reporting requirements apply to wages of individuals subject to mandatory Social Security and Medicare, as well as to wages of individuals covered under a Section 218 Agreement. See [Publication 15](#).

## Indian Tribal Governments and Section 218

Indian tribal governments, while treated as states for other purposes, are not treated as states for Social Security and Medicare tax purposes under IRC Section 7871. Thus, Indian tribal governments do not enter into Section 218 Agreements with SSA and may not participate in a public retirement system as an alternative to paying Social Security and Medicare tax under IRC Section 3121(b)(7)(F). (However, Indian tribal governments can enter into agreements under Section 218A of the Social Security Act to provide coverage for certain Indian tribal council members.)

## Mandatory Medicare Coverage

Prior to April 1, 1986, state and local government employees could only be covered for Medicare through voluntary Section 218 Agreements between the state and the federal government. This changed with the enactment of the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985, which mandated that all state and local government employees hired or rehired after March 31, 1986, must be covered for Medicare, and pay Medicare taxes regardless of their membership in a retirement system. Employees covered by Social Security under a Section 218 Agreement are automatically covered for Medicare.

Public employees already covered under a Section 218 Agreement are covered under Medicare and subject to the tax. Employees who are not covered by Social Security, but are subject to the Medicare-only portion of FICA, are referred to as Medicare Qualified Government Employees (MQGE). Reporting procedures for MQGEs are covered in [Chapter 3](#).

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

The flowchart in [Chapter 1](#) shows how to determine whether Medicare coverage applies.

## Continuing Employment Exception

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

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

In general, the following employment changes are considered continuous employment and qualify the employee for the exception:

- From a state agency to another state agency in the same state.
- From an employer of one political subdivision to an employer in the same political subdivision.

The following are not considered continuous employment for this purpose:

- From a state agency to a political subdivision of that state.
- From a political subdivision to a state agency.
- From one political subdivision to another.
- From a state agency to an agency of another state.

See [Revenue Ruling 2003-46](#), [Revenue Ruling 86-88](#) and [Revenue Ruling 88-36](#), for more information about the continuing employment exception.

The Centers for Medicare & Medicaid Services (CMS) is the federal agency that administers the Medicare program. For more information, go to [CMS.hhs.gov](https://www.cms.hhs.gov).

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

The following are not subject to mandatory Medicare tax even though the services are performed by an employee hired after March 31, 1986. (**Note:** These are the same services that are excluded from mandatory Social Security coverage, discussed earlier.)

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

See [Required Exclusions](#) and [Optional Exclusions](#) for more details on these exclusions.

## **Voluntary Medicare Coverage**

A Section 218 Agreement can be executed to provide Medicare-only coverage for employees who are qualified participants in a public retirement system and not covered under a Section 218 Agreement and not subject to the mandatory Medicare provisions. Contact your State Social Security Administrator for further information. (A list of State Administrators is available at [www.ncsssa.org](http://www.ncsssa.org).)

## Frequently Asked Questions

**1. Are any services excluded from mandatory Social Security and Medicare coverage?**

Yes. The same exclusions apply to [mandatory Social Security](#) and [mandatory Medicare](#); however, some services excluded from mandatory coverage under provisions of the Internal Revenue Code may be covered by a Section 218 Agreement. [IRS, SSA]

**2. If a local government has a public retirement system that qualifies as a FICA replacement plan and does not have a Section 218 Agreement, can employees voluntarily elect to participate in Social Security?**

No. An employee can only participate in Social Security if the position is covered either by the mandatory provisions or by a Section 218 Agreement. Only the State Social Security Administrator can initiate a request for Section 218 coverage. [SSA]

**3. Do college students employed by a university during the summer months qualify for the student Social Security and Medicare exception from mandatory Social Security if they are not regularly enrolled and attending classes at the university during that time?**

If an individual is not enrolled in classes during school breaks of more than five weeks, including summer breaks, the student Social Security and Medicare exception does not apply (other than during payroll periods of a month or less that fall wholly or partially within the academic term). See [Revenue Procedure 2005-11, sections 7.04 and 7.05](#). [IRS]

**4. Are elected and appointed officials considered employees?**

For income tax purposes, elected (or elective) and most appointed officials are defined by IRC Section 3401(c) as employees of the public entity they serve (mayors, members of the legislature, county commissioners, city council members and board or commission members). In general, elected and appointed officials will meet the common-law tests to be considered employees. Regardless of the common-law tests, some positions may be defined as employment by state statute. Some fee-basis officials are by law treated as self-employed. An elected or appointed official who is an employee is subject to rules for mandatory Social Security and Medicare unless covered under a Section 218 Agreement or a qualified participant in a retirement system. All officials elected or appointed to their positions after March 31, 1986, are subject to Medicare withholding. See [Chapter 4](#). [IRS]

**5. How is “termination of employment” defined for purposes of determining whether the continuing employment exception for Medicare tax applies?**

Whether an employment relationship has terminated must be determined based on facts and circumstances. Great weight, however, will be given to the state or political subdivision employer’s personnel rules to determine whether an employment relationship has been terminated. ([Revenue Ruling 86-88](#)) [IRS]

**6. An employee who was hired by the state before April 1, 1986, transferred after March 31, 1986, to another state agency. The transfer was made without terminating the employee’s employment with the state. Does the employee qualify for the continuing employment exception?**

Yes. An employee hired by a state employer before April 1, 1986, who transfers after March 31, 1986, to another state employer of the same state may qualify for the continuing employment exception, provided the transfer was made without a termination of the employee’s overall employment relationship with that state. The same rule applies to an employee hired before April 1, 1986, by a political subdivision employer, who transfers after March 31, 1986, to another employer of that same political subdivision. However, an employee hired before April 1, 1986, does not qualify for the continuing employment exception if after March 31, 1986, the employee transfers from a state employer to a political subdivision employer or from a political subdivision employer to a state employer. Likewise, an employee does not qualify for the exception if the employee transfers from a political subdivision employer in one political subdivision to a political subdivision employer in a different political subdivision, or from a state employer in one state to a state employer in a different state. [IRS]

**7. Can employees who were hired prior to April 1, 1986, and who are not currently paying into Medicare, enroll in Medicare in the future?**

Individual employees can never elect voluntarily to participate in Social Security or Medicare. State or local public employers can voluntarily choose to cover one or more groups of employees under Medicare-only, even if they are otherwise exempt because of the continuing employment exception. To elect this coverage, the state or local government (through the state) must enter into a modification of the state's Section 218 Agreement. Contact your State Social Security Administrator for further information about a Medicare-only modification. If an individual's state or local government employment is not covered under Social Security or Medicare, the individual may not have enough work credits for Medicare based on their own wages. That individual may be entitled to coverage based on sufficient other work covered for Social Security or Medicare on their own earnings record or that of an insured spouse. [SSA]

## ■ Chapter 6

# Social Security and Public Retirement Systems

Effective July 2, 1991, Congress made Social Security coverage mandatory for state and local government employees who are neither covered by a Section 218 Agreement nor qualified participants in a FICA replacement plan. States can provide employees with membership in a public retirement system as an alternative to mandatory Social Security coverage.

As a supplement to the Social Security and public retirement systems information provided in this publication, refer to [IRS.gov/FSLG](https://www.irs.gov/FSLG).

This chapter provides information about the requirements a retirement system must meet to qualify as an alternative to Social Security coverage.

### Public Retirement Systems (FICA Replacement Plans)

A public retirement system, as defined in IRC Section 3121(b)(7)(F) and Treas. Reg. Section 31.3121(b)(7)-2, is a pension, annuity, retirement or similar fund or system maintained by a state or local government that provides a retirement benefit to the employee comparable to the benefit provided under the Old-Age portion of the Old-Age, Survivors and Disability Insurance (Social Security) part of FICA.

To be a retirement system for this purpose, the plan must provide a minimum retirement benefit. In this context, the term “employer” is a state, political subdivision or instrumentality. The term “employee” is used here only to refer to an employee of a state, political subdivision or instrumentality.

**Note:** A “public retirement system” for this purpose is not required to be a qualified plan within the meaning of ERISA. The ERISA provisions relate to the tax treatment of contributions and benefits of employee plans and are irrelevant to the coverage issues addressed here. To avoid confusion, this publication does not use the term “qualified” to refer to public retirement systems. For mandatory coverage purposes, the employee may be a member of any type of retirement system, including a system that is nonqualified under ERISA (for example, a Section 457 plan), as long as the plan provides the minimum level of benefits required for a public retirement system. These requirements are discussed below and in Treas. Reg. Section 31.3121(b)(7)-2(e) and [Revenue Procedure 91-40](#).

For purposes of determining whether mandatory coverage applies for an employee holding more than one position, Social Security is NOT a public retirement system.

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

In general, there are two types of public retirement systems that may meet the minimum benefit requirement — the **defined contribution** plan and the **defined benefit** plan.



## Defined Contribution Plan

A defined contribution plan provides an individual account for each participant. The participants' benefits from this plan are based solely on the amount contributed to their account and any income, expenses, gains or losses that may be allocated to their account. See IRC Section 414(i).

A defined contribution plan that satisfies the definition of a retirement system under Treas. Reg. 31.3121(b)(7)-2(e)(2)(iii) must provide for an allocation to the employee's account of **at least 7.5% of the employee's compensation during any period under consideration**. A variety of plan types could meet the requirement; for example, plans established under IRC Sections 401(a), 403(b) or 457. Contributions from both the employer and the employee may be used to make up the 7.5%. Matching contributions by the employer may be taken into account for this purpose. A plan with only employee contributions would also satisfy the minimum benefit requirement, provided the contributions constitute at least 7.5% of compensation. However, the percent cannot include any earnings on the account.

## Compensation

For a defined contribution plan, the definition of "compensation" used to determine whether the benefit is sufficient must include at least the employee's base pay, provided that the definition of "base pay" is reasonable. Thus, for example, a defined contribution retirement system may disregard overtime pay; bonuses or single-sum amounts received on account of death or separation from service; amounts received under a bona fide vacation, compensatory time or sick pay plan; or amounts received under severance pay plans. Any compensation in excess of the Social Security contribution wage base for that year (\$132,900 in 2019 and \$137,700 in 2020) may also be disregarded for this purpose.

**Example:** A political subdivision maintains an elective defined contribution plan that is a retirement system within the meaning of IRS regulations. The plan is on a calendar year. An employee contributes to the plan at a rate of 7.5% of base pay. Assume that the employee's compensation will reach the Social Security maximum contribution base in October. The employee is a qualified participant in the plan for the entire plan year, even if the employee ceases to contribute to the plan after reaching the maximum contribution base. See Treas. Reg. 31.3121(b)(7)-2(e)(2)(iii)(B).

Generally, for an employee who holds more than one position with the same employer, all compensation with that employer is considered in applying the 7.5% test.

However, at the employer's option, compensation from only one position may be considered, if that position is not part-time, temporary or seasonal. See Treas. Reg. 31.3121(b)(7)-2(c)(2)(iv).

## Reasonable Interest Rate Requirement

Generally, a defined contribution retirement system must credit the employee's account with earnings at a reasonable rate, under all the facts and circumstances. Alternatively, employees' accounts may be held in a separate trust subject to general fiduciary standards and credited with actual earnings of the trust fund. Whether the interest rate is reasonable is determined after reducing the rate to adjust for the payment of any administrative expenses. See Treas. Reg. 31.3121(b)(7)-2(e)(2)(iii)(C).

## Defined Benefit Plan

For purposes of determining whether it qualifies as a public retirement system, a defined benefit plan is any plan other than a defined contribution plan, including a hybrid plan. A defined benefit plan (including a hybrid plan) requires the use of an actuary to calculate benefits based on a formula, generally based on age, years of service and salary level.

A defined benefit retirement system that qualifies as an alternative to Social Security provides for a retirement benefit to the employee that is comparable to the benefit provided by the Social Security part of FICA. Generally, a plan meets the requirement if the benefit under the system is **at least 1.5% of average compensation during an employee's last three years of employment, multiplied by the employee's number of years of service**. Apply the formulas in [Revenue Procedure 91-40](#) and the IRS regulations to determine whether a defined benefit retirement system meets this requirement.

## Who Is a Qualified Participant?

For an employee to be excluded from mandatory Social Security coverage, the employing entity must maintain a retirement system within the meaning of IRC Section 3121(b)(7)(F) and the employee must be a qualified participant in that system, as defined in IRC Section 3121(b)(7)(F) and Treas. Reg. 31.3121(b)(7)-2(d). This test must be applied to each employee separately. An entity may maintain a retirement system in which not every employee is a qualified participant. For both a defined contribution plan and a defined benefit plan, the determination of whether an individual is a qualified participant is made as services are performed; however, there are different tests to determine participation.

### Qualified Participant in a Defined Contribution Retirement System

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

**Example 1:** A state-owned hospital maintains a nonelective defined contribution plan. Under the terms of the plan, employees must be employed on the last day of a plan year 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.

**Example 2:** The situation is the same as in Example 1, 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 they would have received at the end of the year, that is based on compensation earned since the beginning of the 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), the employee is treated as a qualified participant in the plan on that day.

**Example 3:** A political subdivision maintains an elective defined contribution plan. The plan operates on a calendar year. It has two open seasons—in December and June—when employees can change their contribution elections. In December, an employee elects not to contribute to the plan. In June, the employee elects (beginning July 1) to contribute a uniform percentage of compensation for each pay period to the plan for the remainder of the plan year. The employee is not a qualified participant in the plan during the period January-June, because no allocations are made to the employee's account during that time. If the level of contributions during the period of July-December meets the minimum retirement benefit requirement with respect to compensation during that period, the employee is treated as a qualified participant during that period.

**Example 4:** Assume the same facts as in Example 3, except 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 remain 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. See Treas. Reg. 31.3121(b)(7)-2(d)(1)(ii).

### Qualified Participant in a Defined Benefit Retirement System

An employee is a qualified participant in a defined benefit retirement system with respect to services performed on a given day if on that day:

- The employee is (or ever has been) an actual participant in the retirement system, and
- The employee actually has a total accrued benefit that meets the minimum retirement benefit requirement.

An employee may not be treated as an actual participant or as actually having an accrued benefit for this purpose to the extent that the participation or benefit is subject to any conditions (other than vesting) that have not been satisfied. The disqualifying conditions might include a requirement that the employee attain a minimum age, perform a minimum period of service, make an election to participate or be present at the end of the plan year to be credited with an accrual.

**Example:** A political subdivision maintains a defined benefit plan. 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. For purposes of determining whether mandatory Social Security coverage applies, benefits that accrue only upon satisfaction of this 1,000-hour requirement may not be taken into account in determining whether an employee is a qualified participant in the plan before the 1,000-hour requirement is satisfied. See Treas. Reg. 31.3121(b)(7)-2(d)(1)(i).

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

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

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

## **Part-Time Employees**

For purposes of applying the qualified participant test, part-time employees are those who normally work 20 hours or less per week. (This definition of “part-time” should not be confused with a definition of “part-time” that may be used for a Section 218 Agreement.) If mandatory coverage applies, part-time positions cannot be excluded; but part-time positions may be excluded from coverage under a Section 218 Agreement, at the option of the state. Contact the State Social Security Administrator to determine the definition of part-time positions under the state’s Section 218 Agreement.

A special rule provides that a teacher employed by a post-secondary educational institution (a community or junior college, post-secondary vocational school, college, university or graduate school) is not considered part-time if the teacher normally teaches classroom hours of one-half or more of the number of classroom hours normally considered to be full-time employment.

**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 hours designated by the school as constituting full-time employment, the teacher is not a part-time employee. See Treas. Reg. 1.3121(b)(7)-2(d)(2)(iii)(A).

## **Seasonal Employees**

For purposes of applying the qualified participant test, a seasonal employee is any employee who normally works full-time less than five months a year. Thus, for example, individuals who are hired by a political subdivision during the tax return season to process incoming returns and work full-time over a three-month period are seasonal employees. See Treas. Reg. 31.3121(b)(7)-2(d)(2)(iii)(B).

## **Temporary Employees**

For purposes of applying the qualified participant test, a temporary employee is one who performs services under a contractual arrangement that is expected to last two years or less. Under this rule, a teacher under an annual contract may or may not be a temporary employee. Possible contract extensions must be considered in determining the duration of a contractual arrangement if there is a significant likelihood that the employee’s contract will be extended. Contract

extensions are considered likely to occur if, on average, 80% of similarly situated employees have had bona fide offers to renew their contracts in the immediately preceding two academic or calendar years. Contract extensions are also considered significantly likely to occur if the employee has a history of contract extensions in the current position. See Treas. Reg. 31.3121(b)(7)-2(d)(2)(iii)(C).

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

If an employee is not covered by a Section 218 Agreement but is a member of a retirement system for one full-time position, the employee is generally treated as a member of a retirement system for any other position with the same employer.

**Example:** An individual is employed full-time by a county and is a qualified participant in its retirement plan. In addition to this full-time employment, the individual is employed part-time in another position with the same county. The part-time position is not covered by the county retirement plan. Nevertheless, if the individual is a qualified participant in the retirement plan for the full-time position, the part-time position is excluded from mandatory Social Security coverage. See Treas. Reg. 31.3121(b)(7)-2(c)(2).

This rule does not apply to employment by two different employers.

**Example:** An individual is employed full-time by a state and is a member of its retirement plan and is also employed part-time by a city located in the state, but does not participate in the city's retirement plan. The services of the individual for the city are not excluded from mandatory Social Security coverage, because the determination of whether services constitute employment for such purposes is made separately for each political subdivision for which services are performed. See Treas. Reg. 31.3121(b)(7)-2(c)(2).

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

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

**Example:** Assume an employee works 15 hours per week for a county and 10 hours per week for a municipality, and both these employers contribute to the same statewide public employee retirement system. Assume further that the employee's service in both positions is aggregated under the system for all purposes in determining benefits (including vesting). If the employee is covered under the retirement system with respect to both positions and is treated for benefit accrual purposes at least as favorably as full-time employees, then the employee is not considered a part-time employee of either employer. The requirement of being fully vested for determining the applicability of mandatory Social Security coverage does not apply. See Treas. Reg. 31.3121(b)(7)-2(d)(2)(iii)(D).

### **Alternative Lookback Rule**

Under an alternative lookback rule, an employee may be treated as a qualified participant in a retirement system throughout a calendar year if the employee was a qualified participant in the system at the end of the plan year of the system ending in the preceding calendar year.

**Example:** An employee is a qualified participant in a retirement plan of a city on the last day of the plan year, May 31, 2018. If the alternative lookback rule is used, no liability for Social Security tax exists for the employee for calendar year 2019. See Treas. Reg. 31.3121(b)(7)-2(d)(3).

For the first year of participation, an employee who participates in the retirement system may be treated as a qualified participant during the year only if it's reasonable to believe that the employee will be a qualified participant on the last day of the plan year.

## Former Participants

In general, the rules on qualified participants apply to former participants who continue to perform services for the employer or who return after a break in service.

Thus, for example, a former employee, with a deferred benefit under a defined benefit retirement system, who is re-employed by the same employer but does not resume participation in the retirement system, may continue to be a qualified participant in the system after becoming re-employed 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). If this is so, the employer is not required to withhold and pay Social Security tax, or make additional payments to the retirement system on his behalf. The individual's status as a qualified participant must be continually re-evaluated, however, for employment of more than a short period. (Treas. Reg. 31.3121(b)(7)-2(d)(4)(i)).

## Rehired Annuitants

A rehired annuitant is a retiree who is rehired by their employer or another employer that participates in the same retirement system as the former employer. A rehired annuitant is either receiving a retirement benefit from that retirement system, or has reached retirement age under the retirement system.

Rehired annuitants are excluded from mandatory Social Security coverage.

**Example:** A teacher retires from service with a school district that participated in a statewide teachers' retirement system and did not have a Section 218 Agreement. The teacher begins to receive benefits from the system and later becomes a substitute teacher in another school district that participates in the same statewide system. The employee is treated as a rehired annuitant and is not subject to mandatory Social Security tax, but is subject to Medicare tax. See Treas. Reg. 31.3121(b)(7)-2(d)(4)(ii).

However, if an employee is rehired to perform services in a state or local government position that is covered for Social Security under a Section 218 Agreement, services in that position are covered for Social Security. If an individual returns to work for an employer under mandatory coverage, the employment is subject to the mandatory coverage.

**Note:** Retirees rehired after March 31, 1986, are subject to the Medicare tax regardless of whether they qualify as rehired annuitants for Social Security purposes.

## Frequently Asked Questions

### 1. What is a "public retirement system" for purposes of the mandatory coverage rules?

A "public retirement system" (sometimes referred to as a "FICA replacement plan" or simply as a "retirement system") is a pension or other retirement plan maintained by a public employer that meets the requirements of IRC Section 3121(b)(7)(F). See [Revenue Procedure 91-40](#) and Treas. Reg. 31.3121(b)(7)-2. These requirements must be met for a retirement system to be used as an alternative to mandatory Social Security coverage. A retirement system may be a pension, annuity, retirement or similar fund or system established by a state or political subdivision. The system need not be created by the legislature of the state, nor does it have to be a plan under which the benefits are guaranteed by the state constitution. A retirement system can include a group annuity policy purchased by the state or political subdivision from a private insurance company. Whether a system qualifies as a "public retirement system" does not depend on whether it meets the requirements to be a qualified plan under the ERISA. [IRS]

### 2. What does it mean to be a qualified participant in a retirement system?

To be a qualified participant, a member must actually participate in the system. An employee who is eligible for an optional system, but decides not to participate, will be subject to mandatory Social Security tax. Under an alternate rule, an employer is entitled to treat an employee as a qualified

participant for the entire year if they were a qualified participant in the retirement system on the last day of the plan year ending in the previous calendar year. [IRS]

**3. How are part-time, seasonal and temporary workers defined for purposes of determining whether they are qualified participants in a public retirement system under IRC Section 3121(b)(7)(F)?**

A part-time employee normally works 20 hours or less per week. A seasonal employee may work full-time, but for less than five months a year. 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 by the school. A temporary employee performs services under a contractual arrangement of two years or less. Possible contract extensions must be considered in determining the duration of a contractual arrangement if there is a significant likelihood that the employee's contract will be extended. Future contract extensions are considered likely if (1) on average 80% 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 an employee indicates that the employee is not a temporary employee. [IRS]

**4. Are there special vesting rules for part-time, seasonal and temporary workers?**

For part-time, seasonal and temporary employees to be qualified participants in an employer-sponsored retirement plan, they must be immediately and fully (100%) vested in the plan. The vesting requirement for a defined contribution plan is met if an employee has a nonforfeitable right to receive a payment equal to 7.5% of the compensation the employee earned while participating in the system plus a reasonable rate of interest. [IRS]

**5. If a local government participates in a statewide retirement system, is the plan considered "established" by the employer?**

Yes. The fact that each local government is a separate employer for tax purposes is irrelevant. Even though the plan is not maintained by the local government, it is offered through that entity as an employer and is considered established by the employer. [IRS]

**6. For new employees entering a retirement system, is there any waiting period for coverage during which mandatory Social Security and Medicare taxes do not have to be paid?**

If a full-time employee can be enrolled in the plan by the first day of the first full calendar month of service, Social Security and Medicare taxes do not have to be paid during the partial month in which they begin work. This rule does not apply to part-time, seasonal and temporary employees. [IRS]

**7. Is a retirement system that does not cover all employees a "retirement system" within the meaning of Treas. Reg. 31.3121(b)7-2?**

A retirement system is not required to cover all employees; it may be a retirement system for some employees and not for others. The coverage determination is made separately for each individual. [IRS]

**8. A teacher who is a participant in a retirement system during the academic year also works a few hours per week in the summer in the school library. The library job is not covered by a Section 218 Agreement or by the public retirement system because it does not fall during the normal 10-month school year. Are the wages for the summer job subject to Social Security and Medicare taxes?**

The wages are not subject to Social Security taxes because the teacher is a qualified participant in the public retirement system with respect to their full-time job. A teacher who is expected to be employed on a continuing basis qualifies for treatment as employed simultaneously in multiple positions with the same entity. Consequently, the determination may be made solely by reference to service in the teacher's full-time position. The Medicare tax applies, unless the employee was hired prior to April 1, 1986, and qualifies for the continuing employment exception. [IRS]

**9. A teacher retires from a school district, starts collecting a pension under the state retirement system, and returns to work for the same school district as a bus driver. The bus driving position is not covered by a Section 218 Agreement and is not covered by the state retirement system. Is the employee subject to mandatory Social Security tax on the wages as a bus driver?**

No. The employee is a rehired annuitant. He is deemed to be a qualified participant in the retirement system without regard to whether he continues to accrue a benefit. He is subject to Medicare tax because the continuing employment exception cannot apply since the original employment relationship terminated at retirement. [IRS]

## ■ Chapter 7

# Social Security Administration

This chapter discusses the functions of the Social Security Administration that relate to employer tax and information reporting responsibilities.

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

## Organization

SSA's organization features centralized management in Baltimore, Maryland, and a nationwide network of 10 regional offices overseeing approximately 1,230 field offices (FOs), 162 hearing offices, 35 teleservice centers, 6 processing centers and a national data operations center in Wilkes-Barre, Pennsylvania.

All components within SSA's central office perform a supporting role to SSA FOs by providing direction, guidance and material resources. FOs are located in cities and rural communities across the nation and are the agency's main personal point of contact with beneficiaries and the public. Additionally, the Social Security Disability Insurance (SSDI) program depends on the work of 54 offices of Disability Determination Services in all 50 states, the District of Columbia, Guam and Puerto Rico.

For questions about Social Security coverage for specific workers or groups of workers, public employers should first consult the State Social Security Administrator for the state. Public employers who have questions about electronic filing or other SSA reporting processes or reporting applications, should contact the appropriate Employer Services Liaison Officer (ESLO) listed at the [SSA ESLO webpage](#). Direct questions about employer or employee tax liability to the IRS. Direct inquiries about state and local coverage issues to the [SSA State and Local Coverage Specialist](#) for your state or territory.

## Regional Office

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

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

## Office of Income Security Programs

The Office of Income Security Programs is primarily responsible for administering the state and local coverage program. Organizationally, the office is located under the Deputy Commissioner, Retirement and Disability Policy.

## Social Security Earnings Records

The Social Security number (SSN) is used for posting and maintaining the earnings and employment records of persons covered under the Social Security program. Employers withhold Social Security and Medicare taxes from employee paychecks and, with the employer tax, deposit these amounts or pay them with the tax return. (See [Chapter 3](#) for information on reporting and deposit rules.) By the end of January employers file wage reports with the SSA showing the wages paid to each employee during the preceding year. SSA shares this information with the IRS. SSA also sends weekly updates to IRS with information on newly established SSN records and corrected information for previously established SSN records. Reported earnings are posted to the worker's earnings record.

When a worker or a worker's family member applies for Social Security benefits, the worker's earnings record is used to determine the eligibility for benefits and the amount of any cash benefits payable. It is critical that employers maintain accurate, up-to-date SSN information on their employees to make sure each employee's earnings are correctly posted to that employee's earnings record.

Under the Federal Insurance Contributions Act, Social Security and Medicare benefits are financed through taxes paid by employees and their employers. The Social Security and Medicare tax rates are set by law. The tax rate on wages for the OASDI program applies to earnings up to an annual maximum amount. This amount, called the earnings base, is adjusted annually based on changes in average wages. Medicare Hospital Insurance taxes are paid on total earnings; there is no wage base limit for Medicare tax. The Supplementary Medical Insurance part of Medicare is financed by monthly premiums charged to beneficiaries and by payments from general federal 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 2019, one credit is earned for each quarter with \$1,360 in earnings, for up to four quarters per year, adjusted yearly to reflect average wage increases. In 2020 the earnings credit amount increased to \$1,410.

Credits earned remain on the worker's Social Security earnings record, regardless of periods of no earnings. The number of credits an individual needs to be eligible for Social Security and Medicare benefits depends on 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 in case of death.

Beginning in 1957, basic pay earned from active military duty or training in military service may earn Social Security credits. In addition, military service before 1957 may qualify a person for additional earnings credits. A determination of these additional credits is made at the time a person applies for benefits.

State and local government employees covered for Medicare-only must earn the same number of credits to qualify for Medicare as required for Social Security benefits.

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

## Retirement Income

Full Social Security retirement benefits are payable to individuals with 40 credits (10 years of work) at full retirement age (FRA). An individual can elect Social Security retirement benefits as early as age 62, but in that case, the individual's monthly benefit is reduced by an established percentage. In 2003, FRA began to increase in gradual steps from age 65 to 67. This provision affects people born in 1938 and later.



If an individual receives Social Security benefits before reaching FRA, benefits are further reduced if the individual continues to work and earn more than an annual exempt amount. The [annual exempt amount](#) changes each year. A worker can earn up to that amount and not experience any additional reduction of Social Security benefits. If the worker is under FRA and earns over the exempt amount, the benefits will be reduced \$1 for every \$2 in earnings above the exempt amount. In the year the individual reaches FRA, benefits will be reduced \$1 for every \$3 in earnings above the exempt amount.

A spouse or former spouse may qualify for benefits upon a worker's retirement or disability. Benefits are paid as early as age 62, or at any age if the spouse is caring for the worker's child. In this case the child must be under 16 or disabled and receive benefits on the worker's record. A spouse's benefits will be one-half or less of FRA monthly benefit.

The table below indicates earnings requirements and exempt amounts for recent years.

	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
<b>Earnings required for one credit</b>	\$1,260	\$1,300	\$1,320	\$1,360	\$1,410
<b>Exempt annual amount - under full retirement age</b>	\$15,720	\$16,920	\$17,040	\$17,640	\$18,240
<b>Exempt amount - year attaining normal/full retirement age</b>	\$41,880	\$44,880	\$45,360	\$46,920	\$48,600
<b>Full retirement age or older</b>	No limits effective January 2000				

Benefits for divorced spouses age 62 or older may be payable if the insured former spouse is eligible for retirement benefits, even though not yet retired. Unmarried children under the age of 18 (under 19 if in high school) or any age if disabled before age 22 may qualify for Social Security benefits on a retired or disabled parent's Social Security record.

**Note:** Although the full retirement age for Social Security may vary, Medicare eligibility is age 65 for everyone. Eligibility for Medicare is based on benefits as a retired worker, as a spouse of a retired or disabled worker, or as a spouse of a deceased worker. The individual qualifies even if the individual is not receiving 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 Medicare under the regular rules. See [Chapter 5](#).

## **Effect on Benefits from Work Not Covered by Social Security**

There are two situations in which receipt of a pension based on employment not covered by Social Security will affect the amount of a Social Security benefit. Employees who participated in a public retirement system and also have a Social Security benefit based on another retirement system should be aware of these provisions.

The **Windfall Elimination Provision (WEP)** affects the way the Social Security retirement or disability benefit is computed for some individuals with non-covered employment.

The **Government Pension Offset (GPO)** affects the amount of the Social Security benefit received by a spouse or widow(er).

### **Windfall Elimination Provision**

The WEP affects some individuals who receive a monthly pension based in whole or in part on work not covered by Social Security. The weighting in the Social Security benefit formula is intended to help people who spend most of their working lives in low-paying jobs by providing them with a benefit that is higher in relation to their prior earnings than the benefit provided for workers with high career earnings. Before 1983, people who worked mainly in jobs not covered by Social Security had their benefits calculated as if they were long-term, low-wage workers.

Therefore, prior to the WEP, the benefit formula created an unintended advantage for workers who had pensions from non-covered employment in addition to Social Security coverage. It benefited people who worked for only a portion of their careers in jobs covered by Social Security but had their benefits computed as if they were long-term, low-wage workers. WEP was enacted to eliminate this unintended advantage by providing for a different, less heavily weighted benefit formula for persons who receive a pension based on non-covered employment.

If you receive a pension based on work not covered by Social Security, your Social Security retirement or disability benefit is computed using a modified benefit formula. The resulting benefit amount is lower than you would receive if you did not also receive a pension based on non-covered employment.

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

Workers with relatively low pensions are less affected by the law because the reduction in the Social Security benefit cannot be more than one-half of that part of the pension attributable to earnings not covered by Social Security.

The WEP does not apply to:

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

For more information about the WEP, see the SSA [WEP webpage](#) and the [WEP factsheet](#).

## Government Pension Offset

The GPO applies to a worker who gets a government pension that is based on employment not covered by Social Security and is also eligible for Social Security as a spouse or widow/widower. Two-thirds of the government pension is used to offset any spouse's or widow/widower's Social Security benefit.

Before the GPO provisions were enacted in 1977, many government employees qualified for a pension from their government agencies and for a spouse's benefit from Social Security, even though they were not dependent on that spouse.

This situation was considered unfair to employees in Social Security covered positions because Social Security rules require that an individual's benefit as a spouse or surviving spouse be offset dollar for dollar by the amount of their own Social Security retirement benefit.

**Example:** Under GPO rules, an individual eligible for \$1,200 in Social Security retirement benefits on their own work record and also eligible for a spousal benefit of \$900 receives only the higher of the two benefits, \$1,200 in this case. Before enactment of the GPO provision, if that individual was a government employee who did not pay into Social Security and who earned a \$1,200 government pension, there was no offset; and they would receive the \$900 Social Security spousal benefit as well as their \$1,200 government pension. The GPO provision was enacted to prevent such inequities.

For applications filed before April 1, 2004, state and local government workers needed to be covered by Social Security only on the last day of employment with the government entity to be exempt from GPO. Many workers were able to take advantage of this exemption. Congress further tightened the GPO provision on March 2, 2004, with the Social Security Protection Act of 2004.

The Social Security Protection Act of 2004 required that beginning with applications filed April 1, 2004, state and local government workers be covered by Social Security throughout their last 60 months of employment with the government entity to be exempt from the GPO. If the worker's last day of government employment was covered by both Social Security and the pension system, and the last day occurred before July 1, 2004, the worker is exempt from GPO with respect to all current and future applications for spouse's or widow(er)'s benefits. For example, a teacher whose last day of government employment in June 2004 was covered under Social Security and the pension system would be exempt from the GPO regardless of when they filed for benefits.

The Act did provide a transition for workers whose last day of government employment occurred within five years after the date of enactment (March 2, 2004). Any state or local government worker whose last day of government employment occurred after June 30, 2004, and before March 2, 2009, could have the requirement for 60 months of Social Security covered government employment reduced. For these workers, the requirement for 60 consecutive months of Social Security covered employment was reduced (but not to less than one month) by the total number of months that the worker had in Social Security covered government service under the same retirement system before March 2, 2004. If the 60-month period was reduced, the remaining months of service needed to fulfill the requirement must have been performed after March 2, 2004.

**Example:** Ms. Jones was working in a non-covered position at the time of enactment of the GPO but had previously worked in a Social Security covered job in the same retirement system for 12 months in 1997. Because she had previously worked in Social Security covered employment for 12 months, the requirement that her last 60 months of employment be in a Social Security covered position would be reduced to 48 months, or four years. If Ms. Jones began working after March 2, 2004, in Social Security covered employment under the same retirement system as her prior government work, **and** worked continuously in the covered position for at least the final 48-month period of her employment **and** her last day of employment was before March 2, 2009, Ms. Jones would have been exempt from the GPO offset.

All other non-covered state and local government workers who first switched to government employment covered by Social Security and their pension plan after June 30, 2004, had to work in covered government employment for the entire final 60-month period of their government employment in order to avoid the GPO.

The GPO does not apply to pension benefits that are:

- Not based on earnings, or
- Based on earnings in a job where the retiree was paying Social Security taxes, and
  - a. The recipient filed for and was entitled to a benefit as a spouse, widow or widower before April 1, 2004; or
  - b. The last day of employment that the pension is based on is before July 1, 2004; or
  - c. The retiree paid Social Security taxes on earnings during the last 60 months of government service.

Benefits as a spouse, widow or widower will also not be reduced by the GPO if the individual:

- Is a federal employee who elected to switch from the Civil Service Retirement System to the Federal Employees' Retirement System after December 31, 1987; and either:
  - a. Filed for and was entitled to spouse's, widow's or widower's benefits before April 1, 2004; or
  - b. The last day of service (that the pension is based on) is before July 1, 2004; or
  - c. Paid Social Security taxes on earnings for 60 months or more during the period beginning January 1988 and ending with the first month of entitlement to benefits; or
- Received or was eligible to receive a government pension before December 1982 and met all the requirements for Social Security spouse's benefits in effect in January 1977; or
- Received or was eligible to receive a federal, state or local government pension before July 1, 1983, and was receiving one-half support from the spouse.

For more information, see the [GPO Fact Sheet](#).

## Savings Plans for WEP or GPO Purposes

The WEP and GPO apply to pensions provided by state and local government entities. Some public employers not covered by Social Security have established alternative retirement plans, such as a savings plan, instead of a conventional pension plan.

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

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

In addition to savings plans, the following are not considered pensions for purposes of the WEP and GPO:

- A Social Security retirement or disability benefit.
- An early incentive retirement payment.

A survivor annuity is exempt from the WEP; however, Social Security survivor benefits may be affected by the GPO.

**Example 1:** A part-time employee for a city is not covered by a Section 218 Agreement or mandatory Social Security. 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 and the payment will be considered a pension and subject to the GPO or WEP provisions.

**Example 2:** A state employee is not covered by a 218 Agreement but is covered by a state employee retirement system and has also elected to make contributions to a deferred compensation plan. The payment from this deferred compensation plan is separate from and in addition to the primary retirement plan. The employer made no contributions to the deferred compensation plan and the payment from the deferred compensation plan is not based on age, length of service or earnings. While the payment from the retirement system is subject to GPO or WEP, the payment from the deferred compensation plan is not.

SSA [Publication 05-10045](#), Windfall Elimination Provision, and SSA [Publication 05-10007](#), Government Pension Offset, address these topics further. You can also request these publications from the Social Security Administration by calling 800-772-1213. Employers assisting in retirement planning are urged to provide copies of these publications to their employees.

## Medicare

SSA is the primary public contact point for eligibility and premium issues for the Centers for Medicare & Medicaid Services (CMS), which is responsible for administering the Medicare program. SSA staff determines and answers questions on Medicare eligibility. SSA also maintains records of Medicare eligibility and collects Medicare Part B premiums through withholding from Social Security payments.

The Medicare tax supports a federally-funded health insurance program for people age 65 and older and people with certain disabilities. Medicare has four parts:

1. Hospital insurance (Part A) that helps pay for inpatient care in a hospital or skilled nursing facility (following a hospital stay), some home health care and hospice care.
2. Medical insurance (Part B) that helps pay for doctors' services and many other medical services and supplies that are not covered by hospital insurance.
3. Medicare Advantage (Part C) plans, available in many areas through third-party insurers. People with Medicare Parts A and B can choose to receive all of their health care services through one of these provider organizations under Part C.
4. Prescription drug coverage (Part D) that helps pay for medications doctors prescribe for treatment.

You can get more information about Medicare at [www.medicare.gov](http://www.medicare.gov).

## Medicaid

Medicaid provides free or low-cost health insurance coverage to qualifying individuals and families. In 32 states and the District of Columbia, eligibility for SSI benefits confers automatic entitlement to Medicaid. SSA provides information and referral services in support of Medicaid and is directly funded by the states and CMS.

For more information, see [www.medicaid.gov](http://www.medicaid.gov).

## Reporting Wages to SSA

As discussed in [Chapter 3](#), all employers are responsible for collecting Social Security numbers from employees, filing tax returns with the Internal Revenue Service, filing annual wage reports (Forms W-2) with the Social Security Administration, and furnishing copies of Forms W-2 to employees. To avoid costly errors, it's crucial that Form W-2 filing be accurate.

All Forms W-2 sent to SSA are subject to:

- Balancing and validation programs to determine whether the reports are accurate and can be “read” by SSA systems; and
- Employee name and Social Security number 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.

Employers failing to meet filing requirements by the deadlines are subject to IRS late filing (see [Chapter 3](#)).

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

## Electronic Wage Reporting

Employers can submit their W-2 files using SSA's [SSA Business Services Online](#). This option is fast, free and secure. For security, a PIN and a password are required before you submit your W-2 file over this webpage; most registrations can be completed on the webpage. For more information, visit the [SSA employer page](#) or call your ESLO (see list at website).

## Social Security Statement

Individuals can get their personal Social Security statement online by using their [my Social Security account](#). This statement shows all earnings on which a worker has paid Social Security taxes during their working years. It also shows estimates for retirement, disability and survivors benefits. The statements should be examined closely to ensure that all earnings are properly credited. If the earnings shown on the statement are not correct, call SSA at 800-772-1213.

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.

To request a paper statement, call SSA at 800-772-1213 or visit a local field office, or to request by mail, print a copy of Form SSA-7004 and mail the completed form to the address provided. SSA will mail a printout of your Social Security statement within four to six weeks after receipt of your written request.

The Medicare portion of the Social Security statement reflects the amount of earnings that was taxed and an estimate of the amount of taxes paid to support the Medicare program. The taxes are estimated because SSA does not keep records of Medicare taxes paid. If an employee had both Social Security earnings and government earnings that qualified for Medicare in the same year, the statement would reflect an estimate of the combined Medicare taxes paid.

Workers may access online benefit planning tools at the [SSA planning page](#). These can be used to project potential benefits using various earnings scenarios.

**Note:** Individuals who have worked only in non-covered employment (no Social Security and Medicare taxes) will not receive a Social Security statement.

## Verifying Employee Names and Social Security Numbers

After wage reports have been entered into SSA's system, each employee's 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; SSA identifies reports that do not match and contacts the employer or employee to provide a corrected name or SSN. Additionally, IRS may impose a penalty of up to \$270 per misreported name and SSN. Accurate crediting of earnings to individual records is essential to the correct payment of Social Security benefits; this is one reason obtaining a correct name and SSN is very important. See IRS [Publication 15](#), for a discussion of requirements for new hires.

## Social Security Number Verification Service

The [Social Security Number Verification Service](#) (SSNVS) is a free, internet-based service of the SSA Business Services Online (BSO) where employers and third-party submitters can verify their employees' names and SSNs against SSA's records. Employers are required to register with SSA to use the service.

With SSNVS, you may verify up to 10 names and SSNs online and receive immediate results. There is no limit to the number of times the SSN verification webpage may be used within a session. You may upload electronic files of up to 250,000 names and SSNs and will usually receive results the next government business day.

In addition to SSNVS, the BSO offers registration services and employer services. Registration services offers a user identification number (User ID) assignment, password selection and various registration maintenance functions. Employer services offers Form W-2 file upload, W-2 and W-2c online key-in functions (no special software or forms required) and the ability to track files and view processing results and notices. See the [SSA BSO page](#) for more information.

**Note:** SSNVS should only be used for the purpose for which it was intended. SSA will verify SSNs and names solely to ensure that the records of current or former employees are correct for the purpose of completing Form W-2.

## 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](#), Employment Eligibility Verification, verifies that individuals are eligible to work in the United States. Completion of this form is required for every employee hired after November 6, 1986. The U.S. Citizenship and Immigration Service (USCIS) operates [I-9 Central](#), a free website providing employers and employees access to resources, tips and guidance to properly complete Form I-9 and better understand the Form I-9 process.

USCIS also operates an electronic employment eligibility verification system, E-Verify, for employers. If you have questions about Form I-9, contact E-Verify customer support at 888-464-4218 or the [E-Verify webpage](#).

You can download copies of Form I-9 from [www.uscis.gov](http://www.uscis.gov). USCIS Publication M-274, [Handbook for Employers](#), includes Form I-9 and addresses questions relating to the form and employment issues related to immigration. Print copies are available to employers at USCIS regional and district offices, as well as local Government Printing Office bookstores. For questions not addressed in the handbook, visit [www.uscis.gov](http://www.uscis.gov) or call 800-375-5283.

## Correcting Wage Reports

Once information returns have been filed with SSA, you must make any corrections using Form W-2c and Form W-3c.

Forms W-2c may be filed on paper or via electronic transmission. Electronic submissions should be formatted following the instructions in SSA [Publication 42-007](#), Specifications for Filing Forms W-2 Electronically (EFW2), and are available on SSA's website or from any ESLO. A list of the ESLOs is also available at this site.

**Note:** As of February 28, 2006, SSA no longer accepts magnetic media submissions for wage reports. If you are required to file 250 or more Forms W-2c during a calendar year, you must file them electronically unless IRS grants you a waiver. For information on filing [Form 8508](#), Request for Waiver From Filing Information Returns Electronically, contact IRS at 866-455-7438, or visit [www.irs.gov](http://www.irs.gov).

If the employee has a name change, the employee must notify SSA and request a new Social Security card. Never change an employee's name in your payroll system until the employee has shown you a new Social Security card showing the change. See IRS [Publication 15](#) (Circular E), Employer's Tax Guide, for rules on name changes.

If an error is identified before Form W-2 is filed with the SSA, but after providing the form to the employee, changes should be shown on a new original form. This form should be marked "Reissued Statement" at the top. Be sure to change the information submitted to SSA as well, either by marking the original paper W-2 "VOID" at the top (if you submit on paper) or by correcting the data file before filing electronically.

Form W-3c must accompany Copy A of Forms W-2c when they are 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 or multiple Forms W-2c. Large numbers of Forms W-2c may also be filed electronically. Contact your ESLO for details.

## Common Reporting Errors

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

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

**Wage reports for years after employee's death.** Payments on behalf of a deceased employee made after the year of death cannot be credited as wages for Social Security purposes. These payments should be reported to the employee's estate on Form 1099-MISC, Miscellaneous Income. See [Chapter 3](#).

**Errors resulting in out-of-balance reports.** Errors may occur due to application of an incorrect wage base for Social Security or 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 Form W-2. They are not included in the "Social Security wages" 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.

**Wrong tax year form used.** SSA optical scanning and imaging systems are modified annually to meet changes in Form W-2 formats. The version of Form W-2 for the year reported must be used or SSA may be unable to read the form or post the earnings to the wrong year.

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

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

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

**Wrong tax year entered.** Make sure you show the correct tax year on the code "RE" records. Dollar totals ("RT" record) are used by SSA to determine whether the report is in balance and, if it is not, to show where the error may be found. Make sure you report employee names and Social Security numbers correctly.

**Missing/Incorrect submitter (Code “RA”).** This information helps SSA properly identify and control each report. It provides contact information for use if there is a problem with the submission.

**Unreadable reports.** Reports must meet the requirements set out in [EFW2](#) 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 corrected reports timely may result in IRS penalty assessment.

**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 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 “Special Rules for Various Types of Services and Payments” in Publication 15 for information on other non-covered payments.

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

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

## Publications and Forms – Social Security Administration

To request SSA publications, call 800-772-1213 (toll-free) or TTY 800-325- 0778, or email: [DCBFQM.OFLM.OLM.RQCT.Orders@ssa.gov](mailto:DCBFQM.OFLM.OLM.RQCT.Orders@ssa.gov).

You can also download most forms and publications at [SSA.gov/employer](https://ssa.gov/employer).

Publication/Form	Title
<a href="#">Form SS-5</a>	Application for a Social Security Card
	<a href="#">Social Security Number Verification Service (SSNVS) Handbook</a>
<a href="#">Pub. 42-007</a>	Specifications for Filing Forms W-2 Electronically (EFW2)
<a href="#">Pub. 42-014</a>	Specifications for Filing Forms W-2c Electronically (EFW2C)
<a href="#">Form SSA-1945</a>	Statement Concerning Your Employment in a Job Not Covered by Social Security

## Other SSA Services

### 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 800-772-1213.

### Employer Training Seminars

Each year, ESLOs provide a series of free training seminars to annual wage reporters. Call your local ESLO to find out when a seminar is held in your area or check the website for a list of seminars held around the nation.



## Key SSA Webpages

### [Employer W-2 Filing Instructions & Information](#)

This website addresses employer reporting and other interests.

### [Social Security Online](#)

SSA's home page lists available online services such as benefit planners, Social Security statements, Medicare card replacement and so on.

### [State and Local Government Employers](#)

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

### [POMS State and Local Coverage Handbook](#)

The [Program Operations Manual System](#) (POMS) is a primary source of information used by Social Security employees to process claims for Social Security benefits. [The Social Security Handbook](#) is written in plain language for use by the public. [Chapter 10](#) focuses on state and local employment, specifically.

### [Research, Statistics & Policy Analysis](#)

The research and policy analysis information on the SSA website is the result of a collaborative effort among three ORDP offices—the Office of Research, Demonstration and Employment Support, the Office of Research, Evaluation and Statistics and the Office of Retirement Policy. All three offices work together to conduct research and policy analysis and disseminate the results of their research in a variety of publications that are available on the website.

## Frequently Asked Questions

**1. If the IRS is responsible for answering questions on withholding and paying Social Security and Medicare taxes, why do we get reporting information from SSA and why do we have to send IRS Forms W-2 to SSA?**

SSA is responsible for keeping records of earnings and for determining eligibility and amounts for individuals applying for retirement, disability or survivor benefits. The amount of benefits an individual receives is based in part on that individual's earnings over their working career. The information on an individual's earnings record is taken directly from the Social Security and Medicare wage fields on the Form W-2 sent to SSA by the employer. After SSA processes this information, it is forwarded to the IRS. Either IRS or SSA can help you with Form W-2 reporting questions. [IRS/SSA]

**2. 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]

**3. 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]

**4. Whom should I call when I have questions about annual wage reporting?**

Call your local [SSA ESLO](#). See [Chapter 7](#). [SSA]

**5. 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](https://www.irs.gov). Information for federal, state and local governments, including employment tax, is available at [IRS.gov/FSLG](https://www.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
- Independent Office of Appeals
- Taxpayer Advocate Service
- Communications & Liaison

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:

***Taxpayer Services (TS)*** 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](https://www.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](https://www.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](https://www.irs.gov/forms) or order them online or by mail at [IRS.gov/orderforms](https://www.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

<b>Publication/ Form Number</b>	<b>Title</b>
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
1099-NEC	Nonemployee Compensation
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 wholly-owned 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](http://www.IRS.gov) and [www.SSA.gov](http://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 abatement) is clarified to state that it does not apply to periods in which a taxpayer "treated" an individual as an employee.

## SEC. 3. APPLICATION

### .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, 95<sup>th</sup> 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.

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# 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.

Different rules, however, control whether a transfer affects an employee's status for purposes of the Medicare tax wage base. In the case of an employee who is subject to the Medicare tax, even if the employee transfers from one state employer to another state employer of that state or from one political subdivision employer to another political subdivision employer of that political subdivision, a new Medicare tax wage base applies to wages received from the second employer. Thus, the rules that determine whether there is a new Medicare tax wage base are the same as those applicable to employees of private employers.

## **SERVICES EXCLUDED FROM EMPLOYMENT**

- Q8.** What services are excluded from the definition of employment?
- A8.** See sections 3121(b)(1)-(6), (8)-(20) of the Code for a list of services that are excluded from the definition of employment for purposes of the social security taxes, including the Medicare portion of the taxes.
- Q9.** A 218 agreement may contain terms optionally excluding from social security coverage certain types of employment. 42 U.S.C. section 418(c)(3). If employment is optionally excluded from coverage under the terms of a 218 agreement, is that employment subject to the Medicare tax if services are performed by an individual otherwise subject to the Medicare tax under the rules of Q&A1 and Q&A2?
- A9.** Yes. The optionally excluded services are subject to the Medicare tax if they are performed by an individual otherwise subject to the tax under the rules of Q&A1 and Q&A2 above.
- Q10.** A student is hired by a school, college, or university after March 31, 1986, to perform services for the school, college, or university. The student is in a group optionally excluded from coverage under the terms of an applicable 218 agreement. Are the services performed by the student subject to the Medicare tax?
- A10.** Services performed by a student employed by a school, college, or university are not subject to the Medicare tax if the student is enrolled and regularly attending classes at the school, college, or university. Section 3121(b)(10) of the Code. Services of a student that are subject to contributions under a 218 agreement continue to be subject to such contributions.

## **DEFINITION OF WAGES**

- Q11.** Is the definition of wages for Medicare tax purposes the same as the definition of wages for making social security contributions under 218 agreements?
- A11.** No, not in all cases. The term 'wages' for purposes of paying Medicare tax is defined by section 3121(a) of the Code. The term 'wages' for purposes of making contributions under a 218 agreement is defined by section 209 of the Social Security Act. 42 U.S.C. section 409. Questions concerning the definition of wages (and employment) for purposes of paying Medicare tax should be directed to the Service. Questions concerning the definition of wages (and employment) for purposes of making 218 contributions should be directed to the Social Security Administration (SSA).

## **RULES FOR REPORTING AND PAYMENT OF MEDICARE TAX**

- Q12.** Is the Medicare tax reported and paid to the Internal Revenue Service or to the SSA?
- A12.** The Medicare tax is reported and paid to the Service (1) by a state employer of a state if on April 7, 1986, NO employee of any state employer of that state was covered under a 218 agreement, and (2) by a political subdivision employer of a political subdivision if on April 7, 1986, NO employee of any political subdivision employer of that political subdivision was covered under a 218 agreement.

The Medicare tax is reported to the State Social Security Administrator (1) by a state employer of a state if on April 7, 1986, ANY employee of any state employer of that state was covered under a 218 agreement, and (2) by a political subdivision employer of a political subdivision if on April 7, 1986, ANY employee of any political subdivision employer of that political subdivision was covered under a 218 agreement.

- Q13.** A 218 agreement was in effect with state X on or before April 7, 1986. The agreement provided for coverage of employees of a political subdivision employer of political subdivision A but not for coverage of any employee of any political subdivision employer of political subdivision B. After April 7, 1986, a modification of the 218 agreement was executed providing for coverage of some, but not all, employees of a political subdivision employer of political subdivision B. The effective date of the new coverage was April 1, 1986. When that political subdivision employer of political subdivision B reports and pays the Medicare tax on wages for services performed by those of its employees who are not subject to the modification, is the tax reported and paid to the State Social Security Administrator or to the Internal Revenue Service?
- A13.** The tax is reported and paid to the Internal Revenue Service. Modifying a 218 agreement after April 7, 1986, to extend coverage on a retroactive basis does not change the agency to which the employer must report and pay the Medicare tax for services performed by employees who are subject to the Medicare tax.
- Q14.** How is the Medicare tax reported and paid to the Internal Revenue Service?
- A14.** Taxable wages must be reported on line 6 of Form 941E, Quarterly Return of Withheld Federal Income Tax and Hospital Insurance (Medicare) Tax. The reporting, depositing, and paying of the Medicare tax are subject to the same rules applicable to private employers. These rules are similar to those applicable to income tax withholding.
- Q15.** How is the Medicare tax reported and paid to the SSA?
- A15.** The Medicare tax is reported and paid to the SSA just as contributions under a 218 agreement are reported and paid to the SSA.
- Q16.** Will all penalties for failure to pay the Medicare tax and failure to make timely deposits of that tax be assessed against state and political subdivision employers?
- A16.** The Service will waive penalties for failure to pay and for failure to make timely deposits of the Medicare tax with respect to services performed through the fourth quarter of 1986, so long as all payments due for April through December of 1986 are paid by February 2, 1987. If all payments due for April through December 1986 are not paid by February 2, 1987, this automatic waiver of penalties is not applicable, even with respect to amounts paid by February 2, 1987. Penalties may be waived, however, if the employer shows reasonable cause for failure to pay and failure to make timely deposits of the tax. See sections 6651 and 6656 of the Code. A state employer or political subdivision employer should not report any Medicare tax wages on line 6 of Form 941E for the second or third quarter unless appropriate deposits and/or payments are made for that quarter.
- Q17.** If a state employer or a political subdivision employer has federal employees on the state or political subdivision payroll, how should that employer report the full social security tax or the Medicare portion of the social security tax, whichever is applicable?
- A17.** The state employer or political subdivision employer should use Form 941E to report the full social security taxes and or the Medicare portion of the taxes. For those federal employees subject to the FULL social security taxes, the tax must be included with the withheld federal income tax on line 3 of Form 941E, with an attached supporting statement showing the amount of wages subject to the social security taxes, the amount of the taxes withheld, and the employer's share of the taxes. For those federal employees subject ONLY to the Medicare portion of the social security taxes, the Medicare tax must be reported on line 6 of Form 941E.

- Q18.** If a state employer or a political subdivision employer must report and pay the Medicare tax to the Service as explained in Q&A12, how should the employer transmit Copy A of Forms W-2 for newly hired employees who are subject to the Medicare tax?
- A18.** For newly hired employees subject to the Medicare tax, the employer should transmit Copy A of Forms W-2 with a Form W-3, Transmittal of Income and Tax Statements, and should check the 'Medicare Fed. emp.' checkbox in Box 2 on the Form W-3. This checkbox will be changed to 'Medicare government employee' on the 1987 Form W-3 to reflect the extension of the Medicare tax to state and political subdivision employees. For employees not subject to the Medicare tax, the employers should follow the current practice of transmitting Copy A of Forms W-2 with a Form W-3, checking the '941/941r' checkbox in Box 2 on the Form W-3.
- Q19.** If a state employer or a political subdivision employer must report and pay the Medicare tax to the State Social Security Administrator as explained in Q&A12, how should the employer transmit Copy A of Forms W-2 for newly hired employees subject to the Medicare tax?
- A19.** For newly hired employees subject to the Medicare tax, the employer should transmit Copy A of Forms W-2 with a Form W-3 S&L, Transmittal of Income and Tax Statements for State and Local Governmental Employers, and should check the 'Medicare Government Employee' checkbox on the Form W-3 S&L IN ADDITION TO the 'Section 218' checkbox. For those employees covered under a 218 agreement, the state employer or the political subdivision employer should follow the current practice of transmitting the Forms W-2 with a Form W-3 S&L, checking the 'Section 218' checkbox in Box 2 on the Form W-3 S&L. If the employer also has employees who are not covered under the 218 agreement and who were hired before April 1, 1986, then for those employees, the employer should transmit Forms W-2 with a Form W-3 and should check the '941/941u' box on the Form W-3.

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## Revenue Ruling 88-36

### FICA, HOSPITAL INSURANCE; STATE AND POLITICAL SUBDIVISION EMPLOYEES

#### SECTION 3121. - DEFINITIONS

FICA, hospital insurance; state and political subdivision employees. Guidance is provided, in question and answer form, concerning the application of the hospital insurance (medicare) tax portion of the Federal Insurance Contributions Act (FICA) by section 3121(u) of the Code, to wages for services performed by state and political subdivision employees hired after March 31, 1986. Rev. Rul. 86-88 supplemented.

The Service has issued Rev. Rul. 88-36, supplementing Rev. Rul. 86-88, 1986-2 C.B. 172, in question and answer format, which provides guidelines concerning the 1985 amendment to section 3121(u), which extended Medicare (the hospital portion of FICA) to wages for services rendered by state and political subdivision employees hired after March 31, 1986. The ruling addresses such areas as the types of services which are subject to the medicare tax and the continuing employment exception. In general, an individual, who was employed by a state or political subdivision before March 31, 1986 and who was performing regular and substantial services for remuneration, will not be subject to the tax on services performed after that date. This rule applies only if the employment was not terminated after April 1.

This revenue ruling supplements Rev. Rul. 86-88, 1986-2 C.B. 172, which provides guidelines, in question and answer form, concerning the 1985 amendment of section 3121(u) of the Internal Revenue Code. In general, the amendment extends the hospital insurance (medicare) tax portion of the Federal Insurance Contributions Act (FICA) to wages for services rendered by state and political subdivision employees hired after March 31, 1986.

In this revenue ruling, the terms 'state,' 'political subdivision,' 'state employer,' 'political subdivision employer,' and 'continuing employment exception' have the same meanings as in Rev. Rul. 86-88.

#### SERVICES SUBJECT TO THE MEDICARE TAX

- Q1.** If an individual receiving social security retirement insurance benefits was hired as an employee of a state or political subdivision after March 31, 1986, are the services performed by the individual for the state or political subdivision subject to the medicare tax?
- A1.** Yes. The fact that an employee is receiving social security retirement insurance benefits does not affect the employee's liability for the medicare tax.
- Q2.** Are services performed by an election official or election worker for a state employer or political subdivision employer subject to the medicare tax?
- A2.** Yes, unless the remuneration paid in a calendar year for such service is less than \$100. Section 3121(u)(2)(B)(ii)(V) of the Code, added by section 1895(b)(18)(A) of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 852. This amendment is effective for services rendered after March 31, 1986.
- Q3.** A township has a small number of regularly employed fire fighters. To assist these fire fighters, certain residents of the township have volunteered their services in cases of emergency. The township alerts these residents to emergencies by sounding a siren. The township keeps a record of the residents who respond to the emergency calls and periodically pays each such resident a nominal amount for each emergency for which the resident performed services. Are the payments made to the residents by the township subject to the medicare tax?
- A3.** No. The services are considered to be performed by an employee of a state or political subdivision on a temporary basis in case of fire, storm, snow, earthquake, flood, or other similar emergency and thus are not subject to the medicare tax. See Section 3121(u)(2)(B)(ii)(III) of the Code.

## THE CONTINUING EMPLOYMENT EXCEPTION

- Q4.** An individual was hired in September 1984 as a part-time cook by a state hospital to perform two hours of paid service each Sunday preparing the evening meal. The individual is not a patient or inmate of the hospital and has worked two hours each week as an employee of the hospital continuously since September 1984. Are the individual's services performed after March 31, 1986, subject to the medicare tax?
- A4.** No. The continuing employment exception applies here if the individual was performing regular and substantial services for remuneration for the state employer or political subdivision employer before April 1, 1986. Whether this requirement is met is a question of fact. On these facts, the individual's services are determined to be regular and substantial, and the exception applies.
- Q5.** In November 1982, an individual was elected to a state public office for a four-year term beginning in January 1983, making the individual an employee of the state. In November 1986, the individual was re-elected. Are the individual's services performed in the second term that begins in January 1987 subject to the medicare tax?
- A5.** No. The continuing employment exception applies here if the employment relationship has not been terminated after March 31, 1986. The individual was re-elected before the first term expired, so there was no break in the employment relationship.
- Q6.** B, a school district employee, performed regular and substantial services for remuneration for a political subdivision employer during the school year beginning in September 1985 and ending in May 1986. In May 1986, the school district notified B that B's employment would be terminated as of the end of May 1986 because the school district might not receive sufficient funding. B continued to be covered under the school district's health insurance program through August 1986 on the same basis as before May 1986. Sufficient funding was provided, and in September 1986 B began working on the same basis as before. Are B's services performed after August 31, 1986, subject to the medicare tax?
- A6.** No. In fact, B's employment with the school district was continuous because the school district received sufficient funding. The school district's personnel policies indicate that the employment relationship continued because B retained health insurance coverage. See Q&A6 of Rev. Rul. 86-88.
- Q7.** C, a professor at a state university, performed regular and substantial services for remuneration for the university from September 1985 to June 1986. C was granted a leave of absence for the 1986-1987 school year, with the right to return to the same position at the end of the leave. In September 1987, C returned from the leave and resumed the same position with the university. Are C's services performed after returning from the leave of absence subject to the medicare tax?
- A7.** No. The leave of absence was granted by the university and did not terminate the employment relationship. The university's personnel policies indicate that the employment relationship continued because C was given the right to return to the same position. See Q&A6 of Rev. Rul. 86-88.
- Q8.** D taught a two-hour photography course twice a week at a local community college in the spring semester, which began on March 1, 1986. D then signed a three-year agreement with the college that he would teach the same course every spring. When D returned in the spring of 1987, were his services subject to the medicare tax?
- A8.** No. D was performing regular and substantial services for remuneration prior to April 1, 1986. The employment relationship was not terminated, as D had a commitment to return to the same position each spring.
- Q9.** Each summer, a Township Parks Department advertises for workers to cut grass. E was hired by the township in May 1985 to cut grass during that summer. E stopped performing services for the township at the end of that summer. In May 1986, E was again hired by the township to cut grass. Are E's services performed when E returned in

- A9.** Yes. E's employment relationship was terminated after April 1, 1986, as E had no commitment to perform services for the township each summer.
- Q10.** A part-time police officer has been paid on a weekly basis since March 10, 1986, to be 'on call' for a set schedule of hours each week. When the officer is 'on call,' he must stay at his residence and be available to provide assistance in the case of an emergency or to handle any police business that may arise. Are the services performed by the officer after April 1, 1986 subject to the medicare tax?
- A10.** No. Although the officer responds to calls on an 'as needed' basis, he has a set schedule of hours during which he is performing the service of being available to respond to such calls. Based on the above facts, the officer was performing regular and substantial services for remuneration prior to April 1, 1986 and thus, qualifies for the continuing employment exception to the medicare tax.

# Revenue Procedure 91-40

## SECTION 1. PURPOSE

This revenue procedure sets forth rules relating to the minimum retirement benefit requirement prescribed under section 31.3121(b)(7)-2 of the Employment Tax Regulations.

## SECTION 2. BACKGROUND

Section 3121(b)(7)(F), added to the Internal Revenue Code by section 11332(b) of the Omnibus Budget Reconciliation Act of 1990, Public Law No. 101-508, 104 Stat. 1388, generally expands the definition of employment, for purposes of the Federal Insurance Contributions Act (FICA), to include service as an employee for a state or local government entity unless the employee is a "member of a retirement system" of such entity. Section 3121(b)(7)(F) is effective with respect to service performed after July 1, 1991. Thus, wages for services performed after July 1, 1991, received by an employee of a state or local government entity who is not a member of a retirement system of such entity will generally be subject to FICA taxes, and will also be taken into account in determining the employee's eligibility for Social Security and Medicare benefits. Under section 31.3121(b)(7)-2(e) of the regulations, a retirement system generally includes any pension, annuity, retirement or similar fund or system within the meaning of section 218 of the Social Security Act that is maintained by a state, political subdivision or instrumentality thereof to provide retirement benefits to its employees who are participants. However, the definition of retirement system is limited in order to carry out the purposes of section 3121(b)(7)(F) of the Code and the corresponding provisions of the Social Security Act. Under the regulations, in order for service in the employ of a state or local government entity to qualify for the exception from employment under section 3121(b)(7), the employee must be a member of a retirement system that provides certain minimum retirement benefits to that employee. To meet this minimum retirement benefit requirement with respect to an employee, section 31.3121(b)(7)-2(e)(2)(i) of the regulations generally requires that a retirement system provide benefits to the employee that are comparable to those provided in the Old-Age portion of the Old-Age, Survivor, Disability Insurance program under Social Security. Section 31.3121(b)(7)-2(e)(2)(vi) of the regulations provides that the Commissioner may, through guidance of general applicability, promulgate additional testing methods to determine whether a retirement system meets the minimum retirement benefit requirement. This revenue procedure is an exercise of this authority. It outlines a set of safe harbor formulas for defined benefit retirement systems. Benefits calculated under one of these formulas are deemed to meet the minimum retirement benefit requirement. In addition, procedures are set out by which an employer may determine whether retirement benefits calculated under other formulas meet the minimum retirement benefit requirement of the regulations with respect to an employee.

## SECTION 3. DEFINED BENEFIT RETIREMENT SYSTEM SAFE HARBOR FORMULAS

.01 Final and highest average pay formulas.

- (1) Periods of 36 months or less. A defined benefit retirement system that calculates benefits by reference to a participant's average compensation meets the minimum retirement benefit requirement with respect to an employee if it makes available to the employee a single life annuity payable beginning no later than age 65 that is at least 1.5 percent of average compensation for each year (or fraction thereof) of credited service. For this purpose, average compensation may be defined as the average of the employee's compensation over the 36 (or fewer) consecutive or non-consecutive months that provides the highest such average, the average of the employee's compensation for his or her last 36 (or fewer) months of service with the employer, or the average of the employee's compensation for his or her high consecutive or nonconsecutive or final 3 (or fewer) calendar or plan years of service.
- (2) Periods of more than 36 months. A defined benefit retirement system that calculates benefits by reference to a participant's average compensation over a period of more than 36 months meets the minimum benefit requirement in the same manner as a retirement system described in section 3.01(l) except that the

Averaging period	Factor
37-48 months	1.55 percent
49-60 months	1.60 percent
61-120 months	1.75 percent
Over 120 months	2.00 percent



.02 Formulas using fractional accrual rule.

A defined benefit retirement system that calculates benefits based on a pro rata accrual towards a projected normal retirement benefit may meet the minimum retirement benefit requirement in the same manner as provided in section 3.01(l) provided the projected normal retirement benefit under the plan formula is greater than or equal to the benefit described in such section.

.03 Additional requirements for defined benefit plan formulas to meet safe harbors.

(1) Calculation of compensation.

- (a) To meet the requirements of any of the defined benefit safe harbor formulas for plan years beginning after July 1, 1991, a retirement system must calculate benefits based on a definition of compensation that meets the requirements of section 31.3121(b)(7)- 2(e)(2)(iii)(B) of the regulations.
- (b) In the event that the definition of compensation under the retirement system is less inclusive than the definition otherwise permitted under this section, the applicable benefit percentage in the safe harbor formula of section 3.01 must be increased to account for the lower compensation base. The benefit percentage for employees in a retirement system whose benefits are computed using this definition must be multiplied by the ratio of (i) aggregate compensation (defined as under section 3.03(l)(a) and assuming that compensation considered in determining retirement benefits is limited to the contribution base described in section 3121(x)(1)) of these employees to (ii) aggregate compensation (as defined under the plan) of these employees. This ratio may be determined based upon the compensation during the immediately preceding plan year. In the case of a retirement system sponsored by more than one employer, this ratio must be calculated separately with respect to the employees of each employer whose benefits are computed using this definition. The rule in this section 3.03(l)(b) is illustrated by the following example: Example. A defined benefit retirement system maintained by a political subdivision provides a retirement benefit equal to 2.5 percent of a participant's average compensation during his or her last calendar year of service. The compensation used for this purpose satisfies section 3.03(l)(a), except that it caps the compensation taken into account at \$30,000. Assume that the ratio under section 3.03(t)(b) is 150 percent. This figure is derived by comparing the total compensation of employees in the plan (using the plan definition but capping compensation at the FICA contribution base (rather than at \$30,000)) to the total compensation (using only the plan definition of compensation) of employees in the plan. The retirement system meets the requirements of 3.03(l) because the plan benefit percentage of 2.5 percent is more than 150 percent of the applicable safe harbor benefit percentage of 1.5 percent.

(2) Credited service.

- (a) In order to meet the requirements of any of the defined benefit safe harbor formulas, a formula must generally include in credited service the employee's entire period of actual service with the employer since commencing participation in the retirement system, plus any past service credited under the retirement system. A formula may, however, exclude any periods of actual service for the employer that are treated as employment under section 3121(b) of the Code, provided that during such periods the employee did not participate in the retirement system. A retirement system subject to paragraph (f)(2)(i)(B) of section 31.3121(b)(7)-2 of the regulations (relating to the treatment of benefits accrued in plan years beginning prior to January 1, 1993) may also limit service consistent with the rules contained in that paragraph.
- (b) A formula may limit the maximum period of service that is credited for accrual purposes under this rule. If this limit is less than 30 years in the case of formulas described in section 3.01(l) or (2), or 35 years in the case of formulas described in section 3.02, however, the benefit formula must be increased by the ratio of 30 (or 35) years to such lower limit.
- (c) Except as provided in section 3.03(4) with respect to part-time and other classes of employees, a formula may limit the periods of actual service actually credited for accrual purposes under this rule to whole years or similar periods, provided the periods are reasonable.
- (d) The rules in this subsection are illustrated by the following example:  
Example. In 1995, an employee is a participant in a retirement system with 5 years of credited service. Assume that the retirement system provides benefits under a formula described in section 3.01. In January 1996, the employee moves to a position that is not covered by the retirement system. Assume that service in the new position constitutes covered employment under section 3121(b) of the Code for purposes of the

FICA (e.g., because a section 218 voluntary agreement is in effect with regard to such position). In January 1998, the employee returns to the old position and recommences participation under the retirement system. The employee must be treated as being in the employee's sixth year of credited service in determining whether the benefit under the retirement system meets the minimum retirement benefit requirement. This is because the retirement system may generally disregard the service of an employee that constitutes employment under section 3121(b) for purposes of the FICA.

(3) Treatment of prior distributions from the retirement system.

In determining whether the requirements of any of the defined benefit safe harbor formulas are met, prior distributions may continue to be considered as part of the benefit accrued under the retirement system unless they were distributed by the employer without any election by the employee. In addition, if a retirement system gives a former employee credit for benefit determination purposes for periods of prior service with respect to which a prior distribution was made only if the employee contributes to the system an amount equal to all or a portion of the prior distribution (with or without interest), and this option is provided on reasonable terms, such prior service is not required to be taken into account in determining whether the requirements of any of the defined benefit safe harbors are met until the required contribution is actually made. If prior service is not taken into account under this rule, the prior distribution may not be taken into account either. The rules of this paragraph is illustrated by the following example:

Example. An employee retires under the early retirement option under a retirement system maintained by a state government. The employee elects to receive a single sum distribution representing the entire accrued benefit under the plan. Subsequently, the employee is rehired by the same employer. The plan does not provide for any recontribution of the prior distribution. Whether the employee is a member of the retirement system from which the employee received the distribution is determined without regard to the single sum distribution. That is, a single life annuity that is the actuarial equivalent of the single sum may be treated as part of the accrued benefit under the plan. Similarly, all periods of service credited under the plan during the employee's previous service must be considered.

(4) Credited service for part-time, seasonal, and temporary employees.

To meet the requirements of any of the defined benefit safe harbor formulas with respect to a part-time, seasonal or temporary employee for plan years beginning after December 31, 1992, a safe harbor formula may not permit double proration of the employee's benefits under the retirement system. See 29 CFR §2530.204-2(d) for a description of double proration of benefit accruals. Under this rule, the benefit under the retirement system may be prorated either on the basis of full-time service or on the basis of full-time compensation, but may not be prorated based on both service and compensation. In addition, a safe harbor formula may not subject the crediting of service used in calculating the benefit of any part-time, seasonal or temporary employee to any conditions, such as a requirement that the employee attain a minimum age, perform a minimum period of service, be credited with a minimum number of hours of service, make an election in order to participate, or be present at the end of the plan year. The requirements of this section 3.03(4) will be deemed met with respect to an employee, however, if the requirements of section 31.3121(b)(7)-2(d)(2)(ii) of the regulations relating to amounts distributable upon certain events are met with respect to such employee. See section 31.3121(b)(7)-2(d)(2)(iii) of the regulations for the definitions of part-time, seasonal, and temporary employee for this purpose.

.04 Examples of application of safe harbor formulas.

The application of the defined benefit safe harbors are illustrated in the following examples:

Example 1. An employee has been a participant in a state retirement system for 9 years and several months at the beginning of a plan year of the system. The employee has only 9 years of credited service under the system at the beginning of the plan year, however, because the retirement system calculates service for accrual purposes on the basis of whole years of actual service. Under the retirement system, each participant is credited with a retirement benefit based upon the participant's highest average compensation over 36 consecutive months times his or her years of service (as so determined). Assume the retirement system imposes no other conditions on the accrual of benefits and meets the service crediting requirements of section 3.03(2). If at all times during the plan year prior to being credited with a tenth year of service the employee has a total accrued benefit of at least 13.5 percent of his or her highest average compensation (1.5 percent times 9 years), and at all times during the plan year after being credited

with the tenth year of service the employee has a total accrued benefit of at least 15 percent of his or her highest average compensation (1.5 percent times 10 years), and the retirement otherwise meets the requirements of this revenue procedure and the regulations, the employee will be treated as a qualified participant throughout the plan year. This analysis applies without regard to whether the participant actually accrues a benefit in the plan year or is credited with an additional year of service for accrual purposes (e.g., if future accruals under the plan have been frozen or if the participant has obtained the maximum level of benefits under the plan).

Example 2. Assume the same facts as in Example 1, except that the plan grants 1 month of credited service for every whole month of actual service, and that the employee had 111 months of service (9 years and 3 months) at the beginning of the plan year. If at all times during the first month of the plan year prior to being credited with the 112th month of service the employee has a total accrued benefit of at least 13.875 percent of his highest average compensation (1.5 percent times 111 months, divided by 12), and at all times during the first month of the plan year after being credited with the 112th month of service the employee has a total accrued benefit of at least 14 percent of his highest average compensation (1.5 percent times 112 months, divided by 12), and the retirement system otherwise meets the requirements of this revenue procedure and section 31.3121(b)(7)-2(e) of the regulations, the participant is a qualified participant in the plan within the meaning of section 31.3121(b)(7)-2(d)(1) for the entire first month of the plan year.

Example 3. Assume the same facts as in Example 1, except that, instead of crediting only whole years of participation for accrual purposes, the retirement system credits only service during plan years in which a participant has at least 1,000 hours of service. Thus, as in Example 1, the participant has 9 years of credited service at the beginning of the plan year. If at all times during the plan year prior to meeting the 1,000-hour requirement the employee has a total accrued benefit of at least 13.5 percent of his or her highest average compensation (1.5 percent times 9 years), and at all times during the plan year after meeting the 1,000-hour requirement the employee has a total accrued benefit of at least 15 percent of his or her highest average compensation (1.5 percent times 10 years), the employee will be treated as a qualified participant in the retirement system within the meaning of section 31.3121(b)(7)-2(d)(1) of the regulations throughout the plan year.

## **SECTION 4. DEFINED BENEFIT RETIREMENT SYSTEMS WITH BENEFIT FORMULAS NOT DESCRIBED IN THE SAFE HARBORS OF SECTION 3**

### **.01 In general.**

A defined benefit retirement system that calculates benefits under a formula that does not meet one of the safe harbor formulas described in section 3 of this revenue procedure meets the minimum retirement benefit requirement with respect to an employee if the employee's accrued benefit as of the date of the determination is at least as great as the accrued benefit the employee would have if his or her accrued benefit had been calculated under the safe harbor formula in section 3.01(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 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.

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# Guide to the Citations in this Publication

Citation Source	Example	Purpose
<b>Internal Revenue Code</b>	IRC Section 132(a)(1)	Title 26 of the United States Code, the primary statutory authority for laws dealing with federal tax.
<b>Treasury Regulation</b>	Treas. Reg. Section 1.162-2(a)(2)	Provides guidance for new legislation or to address issues that arise with respect to existing Internal Revenue Code sections. Regulations interpret and give directions on complying with the law.
<b>Treasury Proposed Regulation</b>	Prop. Reg. 106897-08	Generally, regulations are first published in proposed form in a Notice of Proposed Rulemaking (NPRM).
<b>Treasury Decision</b>	TD 9696	Document that contains the text of a final or temporary regulation
<b>Revenue Procedure</b>	Rev. Proc. 2020-1	An official statement of a procedure that affects the rights or duties of taxpayers or other members of the public under the IRC, related statutes, tax treaties and regulations and that should be a matter of public knowledge.
<b>Revenue Ruling</b>	Rev. Rul. 2012-25	An official interpretation by the IRS of the IRC, related statutes, tax treaties and regulations. It is the IRS conclusion on how the law is applied to a specific set of facts.
<b>Notice</b>	Notice 98-03	A public pronouncement that may contain guidance that involves substantive interpretations of the IRC or other provisions of the law.
<b>Announcement</b>	Ann. 85-113	A public pronouncement that has only immediate or short-term value.
<b>Private Letter Ruling</b>	PLR 200437030	A written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts. It may not be relied on as precedent by other taxpayers or IRS personnel.
<b>Technical Advice Memorandum</b>	TAM 200222003	Guidance furnished by the Office of Chief Counsel to IRS personnel in response to an internal request concerning technical or procedural questions that develop during a proceeding.
<b>Supreme Court Decision</b>	269 U.S. 514 (1926)	Final decision on tax matter presented to Supreme Court from lower courts.
<b>Social Security Act</b>	42 U.S.C. Section 418	Original 1935 legislation establishing Social Security; now Title 42 of the United States Code.

## Statutory Citations for State Enabling Laws

As of April 2020

State or U.S. Territory	Citation
<b>Alabama</b>	Code of Alabama, Title 36. Public Officers and Employees, Chapter 28, Social Security for State, Municipal, Etc., Employees, § 36-28-1, et seq.
<b>Alaska</b>	Alaska Statutes Annotated, Title 39, Public Officers and Employees, Chapter 30. Insurance and Supplemental Employee Benefits, Article 1, Old Age and Survivors Insurance, § 39.30.010, et seq.
<b>Arizona</b>	Arizona Revised Statutes Annotated, Title 38. Public Officers and Employees, Chapter 5. Social Security and Retirement, Article 1, Social Security for Public Officers and Employees, § 38-701 et seq.
<b>Arkansas</b>	Arkansas Code Annotated, Title 24. Retirement and Pensions, Chapter 1. General Provisions, Subchapter 2. Public Employees' Social Security, § 24-1- 201, et seq.
<b>California</b>	Annotated California Codes, Government Code, Title 2. Government of the State of California, Division 5. Personnel, Part 4. Federal Old Age and Survivors' Insurance, Chapter 1. General Provisions, Definitions, Designation of Special Groups, Article 1. General Provisions and Definitions, § 22000, et seq.
<b>Colorado</b>	Colorado Revised Statutes Annotated, Title 24. Government—State Public Employees' Retirement Systems, Article 53. Public Employees' Social Security, § 24-53-101, et seq.
<b>Connecticut</b>	Connecticut General Statutes Annotated, Title 5. State Employees, Chapter 66. State Employees Retirement Act, Part I. General Provisions, § 5-152 et seq.
<b>Delaware</b>	Delaware Code Annotated, Title 29. State Government, Part V. Public Officers and Employees, Chapter 57. Social Security, § 5701, et seq.
<b>Florida</b>	Florida Statutes Annotated, Title XXXVII. Insurance (Chapters 624-651), Chapter 650. Social Security for Public Employees 650.01, et seq.
<b>Georgia</b>	Code of Georgia Annotated, Title 47. Retirement and Pensions, Chapter 18. Social Security Coverage for Employees of the State and Political Subdivisions of the State, Article 1. General Provisions § 47-18-1, et seq.
<b>Hawaii</b>	Hawai'i Revised Statutes Annotated, Division 1. Government, Title 7. Public Officers and Employees, Chapter 88. Pension and Retirement Systems, Part VI. Federal Social Security for Public Employees, § 88-211, et seq.
<b>Idaho</b>	Idaho Code Annotated, Title 59. Public Officers in General, Chapter 11. Social Security Benefits, § 59-1101, et seq.
<b>Illinois</b>	Smith-Hurd Illinois Compiled Statutes Annotated, Chapter 40. Pensions, Act 5. Illinois Pension Code, Article 21, Social Security Enabling Act 5/21-101, et seq.
<b>Indiana</b>	Annotated Indiana Code, Title 5. State and Local Administration, Article 10.1. Social Security Coverage for Public Employees, Chapter 1. Definitions, 5-10.1-1- 1, et seq.
<b>Iowa</b>	Iowa Code Annotated, Title III. Public Services and Regulation [Chs. 80-122C], Subtitle 3. Retirement Systems [Chs. 97-98A], Chapter 97C. Federal Social Security Enabling Act, 97C.1, et seq.

## Statutory Citations for State Enabling Laws

As of April 2020

<b>State or U.S. Territory</b>	<b>Citation</b>
<b>Kansas</b>	Kansas Statutes Annotated, Chapter 40. Insurance, Article 23. Old-Age and Survivors Insurance for Public Employees, 40-2301.
<b>Kentucky</b>	Baldwin's Kentucky Revised Statutes Annotated, Title VIII. Offices and Officers, Chapter 61, General Provisions as to Offices and Officers; Social Security for Public Employees; Employees Retirement System, General Provisions, Social Security for Public Employees, 61.410, et seq.
<b>Louisiana</b>	Louisiana Statutes Annotated, Louisiana Revised Statutes, Title 42. Public Officers and Employees, Chapter 13. Old Age, Survivors, Disability, and Health Insurance, § 1001, et seq.
<b>Maine</b>	Maine Revised Statutes Annotated, Title 5. Administrative Procedures and Services, Part 21. Social Security for State and Municipal Employees, Chapter 431. Social Security for State and Municipal Employees, § 19001, et seq.
<b>Maryland</b>	Annotated Code of Maryland, State Personnel and Pensions, Division III. Other Retirement and Pension Provisions [Titles 35-End], Title 36. Social Security Benefits, § 36-101, et seq.
<b>Massachusetts</b>	Massachusetts General Laws Annotated, Part I. Administration of the Government (Ch. 1-182), Title XVII. Public Welfare (Ch. 115-123B), Chapter 118C. Coverage of Certain Employees Under the Federal Social Security Act, § 1, et seq.
<b>Michigan</b>	Michigan Compiled Laws Annotated, Chapter 38. Civil Service and Retirement, Social Security for Public Employees, 38.851, et seq.
<b>Minnesota</b>	Minnesota Statutes Annotated, Retirement (Ch. 352-356B), Chapter 355. Social Security Coverage, State and Local Government Employees, § 355.01, et seq.
<b>Mississippi</b>	West's Annotated Mississippi Code, Title 25. Public Officers and Employees; Public Records, Chapter 11. Social Security and Public Employees' Retirement and Disability Benefits, Article 1. Social Security Benefits, § 25-11-1, et seq.
<b>Missouri</b>	Vernon's Annotated Missouri Statutes, Title VIII. Public Officers and Employees, Bonds and Records, Chapter 105. Public Officers and Employees--Miscellaneous Provisions Generally, § 105.005, et seq.
<b>Montana</b>	Montana Code Annotated, Title 19. Public Retirement Systems, Chapter 1. Social Security, Part 1. General Provisions, § 19-1-101, et seq.
<b>Nebraska</b>	Revised Statutes of Nebraska Annotated, Chapter 68. Public Assistance, Article 6. Social Security, §68-601, et seq.
<b>Nevada</b>	Nevada Revised Statutes Annotated, Title 23. Public Officers and Employees (Chapters 281-289), Chapter 287. Programs for Public Employees, Participation of Employees of State and Its Political Subdivisions in Federal Old-Age and Survivors' Insurance, §287.050, et seq.
<b>New Hampshire</b>	Revised Statutes Annotated of the State of New Hampshire, Title VI. Public Officers and Employees (Ch. 91 to 103), Chapter 101. Old Age and Survivors' Insurance, §101:1, et seq.
<b>New Jersey</b>	New Jersey Statutes, TITLE 43. Pensions and Retirement and Unemployment Compensation, Subtitle 9 Social Security, Chapter 22, Old Age and Survivors Insurance for Public Employees, § 43:22-1, et seq.



## Statutory Citations for State Enabling Laws

As of April 2020

State or U.S. Territory	Citation
<b>New Mexico</b>	New Mexico Statutes Annotated, Chapter 10. Public Officers and Employees, Article 14. Social Security Coverage § 10-14-1, et seq.
<b>New York</b>	McKinney's Consolidated Laws of New York Annotated, Retirement and Social Security Law, Chapter 51-A of the Consolidated Laws, Article 1. Short Title § 1. Short title of chapter, Article 3. Federal Old-Age and Survivors Insurance Coverage for Certain Public Employees § 130, et seq.
<b>North Carolina</b>	North Carolina General Statutes Annotated, Chapter 135. Retirement System for Teachers and State Employees; Social Security; State Health Plan for Teachers and State Employees, Article 2. Coverage of Governmental Employees Under Title II of the Social Security Act § 135-19, et seq.
<b>North Dakota</b>	North Dakota Century Code Annotated, Title 52. Social Security, Chapter 52-10. Public Employees Under Federal Social Security § 52-10-01, et seq.
<b>Ohio</b>	Baldwin's Ohio Revised Code Annotated, Title I. State Government, Chapter 144. Old Age and Survivors Insurance--Municipal Employees 144.01, et seq.
<b>Oklahoma</b>	Oklahoma Statutes Annotated, Title 51. Officers, Chapter 4. Old Age and Survivors Insurance Under Federal Act, § 121, et seq.
<b>Oregon</b>	Oregon Revised Statutes Annotated, Title 22. Public Officers and Employees, Chapter 237. Public Employee Retirement Generally, Social Security Act Coverage, 237.410, et seq.
<b>Pennsylvania</b>	Purdon's Pennsylvania Statutes and Consolidated Statutes, Title 65 P.S. Public Officers, Chapter 10. Public Officer and Employee Social Security Contribution Law § 201, et seq.
<b>Puerto Rico</b>	Laws of Puerto Rico Annotated, Title Three. Executive, Chapter 33. Retirement of Government Personnel Federal social security for Puerto Rico § 813, et seq.
<b>Rhode Island</b>	General Laws of Rhode Island Annotated, Title 36. Public Officers and Employees, Chapter 7. Federal Old-Age and Survivors' Insurance, § 36-7-1, et seq.
<b>South Carolina</b>	Code of Laws of South Carolina 1976 Annotated, Title 9. Retirement Systems, Chapter 3. Coverage of Public Officers and Employees, Under Federal Social Security Act, Article 1. General Provisions § 9-3-10, et seq.
<b>South Dakota</b>	South Dakota Codified Laws, Title 3. Public Officers and Employees, Chapter 3-11. Social Security Coverage 3-11-1, et seq.
<b>Tennessee</b>	West's Tennessee Code Annotated, Title 8. Public Officers and Employees, Chapter 38. Social Security § 8-38-101, et seq.
<b>Texas</b>	Vernon's Texas Statutes and Codes Annotated, Government Code, Title 6. Public Officers and Employees, Subtitle A. Provisions Generally Applicable to Public Officers and Employees, Chapter 606. Social Security, Subchapter A. General Provisions § 606.001, et seq.
<b>Utah</b>	Utah Code Annotated, Title 67. State Officers and Employees, Chapter 11. Federal Social Security § 67-11-1, et seq.
<b>Vermont</b>	Vermont Statutes Annotated, Title Three. Executive, Part 1. Generally, Chapter 19. Social Security for State and Municipal Employees § 571, et seq.

## Statutory Citations for State Enabling Laws

As of April 2020

<b>State or U.S. Territory</b>	<b>Citation</b>
<b>Virginia</b>	Annotated Code of Virginia, Title 51.1. Pensions, Benefits, and Retirement, Chapter 7. Federal Social Security for State and Local Employees § 51.1-700, et seq.
<b>Virgin Islands</b>	Bill Number 10, Sixteenth Session, 1951.
<b>Washington</b>	Revised Code of Washington Annotated, Title 41. Public Employment, Civil Service, and Pensions, Chapter 41.48. Federal Social Security for Public Employees 41.48.010, et seq.
<b>West Virginia</b>	Annotated Code of West Virginia, Chapter 5. General Powers and Authority of the Governor, Secretary of State and Attorney General; Board of Public Works; Miscellaneous Agencies, Commissions, Offices, Programs, Etc., Article 7. Social Security Agency, § 5-7-1, et seq.
<b>Wisconsin</b>	Wisconsin Statutes Annotated, Public Employee Trust Fund (Ch. 40), Chapter 40. Public Employee Trust Fund, Subchapter III. Social Security for Public Employees 40.40, et seq.
<b>Wyoming</b>	Wyoming Statutes Annotated, Title 9. Administration of the Government, Chapter 3. Compensation and Benefits, Article 3. Social Security § 9-3-301, et seq.



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