



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF THE CHIEF COUNSEL

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Dear _____ :

I apologize for the delay responding to your inquiry to IRS Commissioner Charles P. Rettig, dated March 1, 2019. You asked about the Social Security coverage of the

_____ has an agreement with the Social Security Administration (SSA) under Section 218 of the Social Security Act (Section 218 agreement) providing Social Security coverage to certain government employees. According to your letter, the _____ Section 218 agreement does not provide Social Security coverage for the _____. However, you have indicated that the _____ currently participate in a defined contribution retirement system that is designed to qualify their employment as not subject to Social Security coverage or Social Security tax under Section 3121(b)(7)(F) of the Internal Revenue Code (Code).

The _____ is interested in extending Social Security coverage to _____ and newly hired _____. Therefore, the _____ is considering amending its retirement system for _____ so _____ and new participants would have reduced contribution levels as a percentage of compensation, with the goal that these participants would become subject to Social Security tax. It is our understanding that _____ legislation will be required for you to accomplish this change and that this legislation will soon be proposed. You are interested in getting a definitive statement from the IRS about whether the

with the reduced contribution rate will cease to be members of a retirement system under Section 3121(b)(7)(F) and become subject to Social Security tax.

Although we cannot provide a ruling letter at this time, we can provide an information letter, which gives general information about the Social Security tax provisions.

As we discussed in our telephone conversation, there are certain situations in which the IRS will not issue letter rulings. Section 9 of Revenue Procedure 2019-1, 2019-1 I.R.B. 1 provides that rulings or determination letters will not ordinarily be issued with respect to a matter involving the federal tax consequences of any proposed federal, state, local, municipal, or foreign legislation. The revenue procedure also states that the IRS may provide general information in response to an inquiry. The revenue procedure further provides that the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) may issue letter rulings about the effect of proposed state, local, or municipal legislation upon an eligible deferred compensation plan under Section 457(b). However, it appears this exception does not apply to your retirement plan because it is not an eligible deferred compensation plan under Section 457(b). Because at this time your letter involves the federal tax consequences of proposed legislation, we can't issue a letter ruling now and are providing this general information letter.

The following paragraphs cover established principles in the law and regulations that we hope will be helpful.

The Federal Insurance Contributions Act (FICA), which is chapter 21 of the Code, imposes Social Security and Medicare taxes on wages paid to employees. Wages are defined as all remuneration for employment, unless specifically excepted and "employment" is defined in Section 3121(b) of the Code as meaning any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions.

. The services of employees of states are subject to different rules about:

- (1) Medicare taxation under Section 3101(b) and 3111(b) of the Code; and
- (2) Social Security taxation under Section 3101(a) and 3111(a) of the Code.

Medicare taxation generally applies to the services of state and local government employees unless the "continuing employment exception" applies. See Section 3121(u)(2). The continuing employment exception applies only to employees who have been continuously employed since April 1, 1986, by a single state or local employer and who meet certain other requirements described in Section 3121(u)(2)(C) of the Code.

For Social Security tax purposes, Section 3121(b)(7) provides an exception from employment for services performed in the employ of a state, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby. However, this exception does not apply if the services are covered under a Section 218 agreement between a state and the SSA, and therefore these services are subject to Social Security tax. If the employee's services are not covered under a Section 218 agreement, services can be excepted from the definition of employment for Social Security tax purposes if the employee is a member of a retirement system of the state, political subdivision or instrumentality employer. If the services are not covered under a Section 218 agreement and the employee is not a member of a retirement system of such state, political subdivision or instrumentality employer, then generally Social Security tax applies to the employee's services.

Because your question relates to workers who are not covered under Section 218 agreements and who are members of a defined contribution retirement system of a state, political subdivision or instrumentality, our general information focuses on defined contribution plans.

Section 31.3121(b)(7)-2 of the Employment Tax Regulations provides rules for determining whether an employee is a "member of a retirement system" for purposes of Section 3121(b)(7)(F) of the Code. These rules generally treat an employee as a member of a retirement system if he or she participates in a system that provides retirement benefits and has an accrued benefit or receives an allocation under the system that is comparable to the benefits he or she would receive under Social Security. A defined contribution retirement system maintained by a state or governmental entity meets the requirement for providing a minimum level of benefits regarding an employee if allocations to the employee's account (not including earnings) for any period under consideration are at least 7.5 percent of the employee's compensation for the governmental entity during the period. Contributions by the employer may be considered to make up the 7.5 percent.

Section 31.3121(b)(7)-2(d)(1)(ii) of the regulations provides that whether an employee is a qualified participant in a defined contribution retirement system is determined as services are performed. An employee is a qualified participant in a defined contribution or other individual account retirement system regarding service performed on a given day if, on that day he or she has satisfied all conditions (other than vesting) for receiving an allocation to his or her account (exclusive of earnings) that meets the 7.5 percent of compensation minimum retirement benefit during any period ending on that day and beginning on or after the beginning of the plan year of the retirement system. An employee who is a qualified participant in a defined contribution system is not subject to Social Security tax.

The regulations include examples that illustrate the effect of an employee changing the

level of contributions during a plan year. In Example 3 in Section 31.3121(b)(7)-2(d)(1)(ii) of the regulations, a political subdivision maintains an elective defined contribution plan that is a retirement system. The plan has a calendar year plan year and two open seasons in December and June. The example provides that the employee who did not make contributions during the first six months of the plan year but begins making contributions in July, is a qualified participant during the July to December period if the level of contributions during that period meets the minimum allocation requirement of 7.5 percent of compensation, but is not a qualified participant during the January to June period.

Example 4 of Section 31.3121(b)(7)-2(d)(1)(ii) of the regulations, is based on similar facts as in example 3, but the employee makes contributions for the July to October period and stops making contributions during the rest of the calendar year. The example states that if the contributions during the period from July to October are high enough to meet the minimum allocation requirement of 7.5 percent of compensation during that period, the employee is treated as a qualified participant during that period. The example states, that in addition, if the contributions during the period from July to October are high enough to meet the requirements for the entire period of July to December, the employee is treated as a qualified participant in the plan throughout the period from July to December, even though no allocations are made to the employee's account in the last two months of the year. Example 4 goes on to state the general principle that 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 made.

I hope the above information is helpful to you. If you would like to discuss this matter further, please contact me or _____ at _____, which is not a toll-free number.

Sincerely,

Lynne A. Camillo
Chief, Employment Tax Branch 2
Office of the Associate Chief Counsel (Employee
Benefits, Exempt Organizations, and Employment
Taxes)