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Section 218 Tools, Tips and Compliance for Government Entities

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INTRODUCTION TO SECTION 218

Section 218 coverage involves agreements between a state and the Social Security Administration to provide social security and/or Medicare coverage to employees of governmental entities.

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INTERNAL REVENUE SERVICE Federal State and Local Governments

- Provides a clear point of contact for all government entities for their tax issues.
- Responsible for administering the Internal Revenue Code, performing examinations and compliance checks, conducting outreaches, and collecting taxes.

SL 10001.120

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SOCIAL SECURITY ADMINISTRATION

- Responsible for administering the Social Security Act and interpreting its provisions, as well as interpreting Section 218 Agreements and modifications.
- Final determinations regarding State Section 218 Agreements are governed by Federal law and are made by SSA.

SL 10001.120

SL 20001.210

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**NATIONAL CONFERENCE OF
STATE SOCIAL SECURITY
ADMINISTRATORS**

- Proactively work with SSA and IRS to address social security and Medicare coverage and employment tax issues
- Work with federal officials to ensure legislative and regulatory changes address state and local concerns

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**STATE SOCIAL SECURITY
ADMINISTRATORS**

- Responsible for administering and maintaining the State's Section 218 Agreement.
- Acts as a liaison between state and local government employers and federal agencies.
- Principal state official responsible for these functions. SSA, IRS, public employers and employees should contact the designated Administrator to help resolve questions as to who is and is not covered.

SL 10001.130
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**CURRENT STATUS OF
PUBLIC EMPLOYEES**

- Employees not covered by a retirement system are covered for Social Security and Medicare
 - under a Section 218 Agreement or
 - mandatorily under Federal law (with certain exceptions)

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CURRENT STATUS OF PUBLIC EMPLOYEES

- Employees covered by a retirement system may be:
 - covered for Social Security and Medicare under a 218 Agreement
 - not covered for Social Security and Medicare
 - covered for Medicare only

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BASIC CONCEPTS OF SECTION 218 COVERAGE

- Coverage is voluntary and obtained through a legal written Agreement between State and SSA
- Must be legal authority under both Federal and State law to enter into Agreement
- Types and extent of coverage must be consistent with Federal and State laws

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BASIC CONCEPTS (CONT'D)

- Employees brought under Section 218 Agreement in groups known as “coverage groups”
- Agreements cover positions, therefore, any worker filling that position is covered
- Additional coverage provided by modifications to the Agreement
- Each modification, like the original Agreement, is a legal document

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BASIC CONCEPTS (CONT'D)

- Each State determines which groups of employees to cover and when coverage begins
- Coverage cannot be terminated

SL 30001.303
SL 30001.385
SL 40001.480

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KEY DATES

- 1951 - States may cover employees not covered by a retirement system
- 1955 - States may extend coverage to employees covered by a retirement system
- 1956 - Certain States may divide a retirement system based on "yes" votes

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KEY DATES

- 1965 - Medicare enacted and included in Section 218 Agreements
- 1983 - States can no longer terminate agreements
- 1986 - Mandatory Medicare coverage for public employees hired after March 31, 1986

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KEY DATES

- 1986 - Modifications providing Medicare-only coverage to employees hired before April 1, 1986 could be executed after a successful referendum was held
- 1987 - IRS assumes tax collection responsibility
- 1991 - Mandatory Social Security and Medicare coverage for employees not covered by a retirement system

(SL 30001.395)

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KEY DATES

- 1994 - States may extend coverage to police and firefighters covered by a retirement system
- 2004 - Public employers required to disclose to newly hired employees retirement benefits not covered by social security

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KEY POINT

- Despite the diverse number of provisions governing State and local coverage, one aspect of the process has been consistent:

Coverage for public employees is activated by a Section 218 agreement between the State and SSA on behalf of those employees.

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SECTION 218 AGREEMENT

- Section 218 of the Social Security Act prescribes in detail how coverage may be provided, for whom and under what conditions.
- Original Section 218 Agreement outlines basic provisions, definitions and conditions

SL 20001.230

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SECTION 218 AGREEMENT (CONT'D)

- Provides authority for optional exclusions
- Allows up to 5 years of retroactive coverage
- State enabling legislation must provide authority

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STATE ENABLING LEGISLATION

- Provides legal authority for State to enter into Agreement, to cover services pursuant to the terms of the Agreement, and to carry out the provisions of the Agreement.
- Outlines State's responsibilities under Section 218

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**STATE ENABLING LEGISLATION
(CONT'D)**

- Indicates extent coverage may be provided within State
- Indicates extent to which optional exclusions may be exercised
- Provides authority to divide retirement systems
- Provides Governor authority to conduct referendums

SL 30001.332
SL 40001.401
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SECTION 218 AGREEMENTS

- All States, Puerto Rico, Virgin Islands and more than 60 interstate instrumentalities have a Section 218 Agreement
- Coverage under Section 218 agreements varies widely

SL 20001.201

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INTERSTATE INSTRUMENTALITY

- An independent legal entity organized by two or more States to carry on some function of government. For Section 218 purposes, an interstate instrumentality has the status of a State.
- Ex: Regional planning authority, transportation system or water district.

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INTERSTATE INSTRUMENTALITY

- As required for States, must have legal authority to enter into a Section 218 Agreement.
- This authority is generally conferred in the enabling acts of member States and in the statutes establishing the instrumentality.

SL 30001.305

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TO WHAT ENTITIES CAN A SECTION 218 AGREEMENT APPLY?

The agreement can apply to

- employees of the State
- to employees of the State and any one or more political subdivisions
- or to employees of any one or more political subdivisions.

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WHAT IS A POLITICAL SUBDIVISION?

- A separate legal entity vested by the State with specific functions of government
- Legal status of entity determined by State law
- Ex: cities, counties, water districts

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WHAT A MODIFICATION IS

A modification is a written agreement between the State and SSA to make the original Agreement applicable to employee positions not previously covered, or to modify the original Agreement in some other respect.

SL 40001.420

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WHEN A MODIFICATION IS NEEDED

- Implement changes in the law
- Provide coverage for retirement systems
- Cover new entities (libraries, water districts) not covered by a retirement system
- Cover services optionally excluded (Ex: part-time positions)

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WHEN A MODIFICATION IS NEEDED (CONT'D)

- Provide Medicare-only coverage for pre-1986 hires
- Increase threshold amount for election worker services
- Identify new entities that join a State retirement system
- Correct errors

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WHAT IS A COVERAGE GROUP?

Two categories of coverage groups:

- Non-retirement system coverage groups (Section 218(b)(5) of the Act)
 - Also known as absolute coverage groups
- State does not need employee consent

SL 30001.310
SL 30001.315
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RETIREMENT SYSTEM COVERAGE GROUP

- Retirement system coverage groups (Sections 218(d)(4) and (d)(6) of the Act)
- States required to conduct a referendum for employees covered by a retirement system

SL 30001.320
SL 30001.340
SL 30001.350
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REFERENDUM

- Referendum process is a State matter
- Certain minimum conditions, outlined in the Act, must be met
- Requires Governor (or designee) to certify conditions were met

SL 30001.323

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RETIREMENT SYSTEM REFERENDUM

- Majority Vote Referendum 218(d)(4)

If vote is favorable, all current and future retirement system members, optionals, and ineligible are covered.

All States authorized to use majority vote referendum.

SL 30001.323
SL 30001.324
SL 30001.340
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RETIREMENT SYSTEM REFERENDUM

- Divided Vote Referendum 218(d)(6)

Contact your State Social Security Administrator for questions concerning divided vote referendums.

SL 30001.330
SL 30001.334

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DIVIDED VOTE AUTHORITY

- 23 States have divided vote authority (§218(d)(6)(C))
- See SL 30001.330 for a list of these states
- Some States have not exercised their option to conduct divided vote referendums (need State enabling law)

SL 30001.330
SL 30001.332

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RETIREMENT SYSTEMS

- For Section 218 purposes, a retirement system is a pension, annuity or similar fund or system established by a State or political subdivision thereof.
- State law determines whether a position is under a retirement system and if an individual is a member of a retirement system.

SL 30001.320
SL 30001.331

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CONTINUATION OF COVERAGE

Generally, once coverage is provided, it continues unless an event occurs which may result in termination of coverage.

- Entity dissolves
- Change in employer

SL 30001.380
SL 30001.390
SL 40001.485

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CONTINUATION OF COVERAGE

Example:

School teacher works for School District A (218 coverage); resigns and accepts a position with School District B (non-covered). No longer covered.

SL 30001.380

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CONTINUATION OF COVERAGE RULES

- Non-Retirement system groups

Positions continue to be covered even if, at a later date, covered by a retirement system

- Ex: Water district's 218 Agreement, effective January 1, 1959, covered all positions. On July 1, 1994, district joins State's public retirement system. 218 coverage continues for all employees.

SL 30001.345
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CONTINUATION OF COVERAGE RULES

Retirement system coverage group

- Majority Vote Referendum –

Coverage continues even if the positions are covered by an additional retirement system, the system is abolished or positions are removed from the retirement system.

- Divided Vote Referendum

SL 30001.324
SL 30001.380
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CONTINUATION OF COVERAGE RULES

- Consolidations, Annexations and Miscellaneous Transitions These situations are fact dependent. It must be determined whether there was an annexation, consolidation, reorganization, a name change, or if a new legal entity was created. Sometimes requires an Attorney General Opinion.

SL 60001.680 - 683
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**EXCLUSIONS –
MANDATORY AND OPTIONAL**

- Mandatory exclusions--Federal law mandatorily excludes certain services from Section 218 coverage
- Optional exclusions--Federal law gives the State the option to include or exclude certain services from coverage under the State's agreement

SL 30001.355
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MANDATORY EXCLUSIONS

- Individuals hired solely to be relieved from unemployment
- Services performed in a hospital, home or other institution by a patient or inmate thereof
- Workers hired temporarily to handle disaster emergencies

SL 60001.635
SL 60001.655
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**MANDATORY EXCLUSIONS
(CONT'D)**

- Transportation system employees who are covered mandatorily under Section 210(k) of the Act
- Non-resident aliens with F-1, J-1, M-1 or Q-1 visas

SL 30001.356
SL 30001.358
SL 30001.365
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RULES FOR OPTIONAL EXCLUSIONS

- States can take optional exclusions for non-retirement system and retirement system coverage groups.
- States can exercise option on a statewide basis or allow each political entity to decide.

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OPTIONAL EXCLUSIONS

- Elective positions
- Part-time positions
- Fee-basis positions
- Agricultural labor
- Election worker services
- Student services

SL 30001.357

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ADDITIONAL RULES FOR OPTIONAL EXCLUSIONS

- In general, if the optional exclusions are not taken when the coverage group is brought under the Agreement, they are covered.

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ELECTION WORKERS

- Compensation paid less than a statutorily established amount (\$1,500 for calendar year 2011), generally not subject to Social Security and Medicare tax, unless those wages are subject to social security and Medicare under the State's Section 218 Agreement.
- State's Agreement may specify a lower threshold amount for election workers (for example, \$50 a calendar quarter).

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ELECTION WORKERS

- Social Security and Medicare taxes do not apply until the election worker is paid at least the threshold amount specified in the State's agreement. Social Security and Medicare taxes will then apply from the first dollar paid.
- If the Section 218 Agreement does not exclude election workers from coverage, Social Security and Medicare taxes apply from the first dollar paid.

SL 30001.357
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STUDENT SERVICES

Students working for the school, where they are currently enrolled and regularly attending, is not an automatic exclusion. It must be determined whether the State covered student services under the State's Section 218 Agreement.

SL 30001.357

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MANDATORY SOCIAL SECURITY AND MEDICARE

- Almost all state and local 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.
- As of July 2, 1991, social security coverage is mandatory, with some exceptions, for state and local government employees who are neither covered by a Section 218 Agreement nor qualified participants in a public retirement system.

SL 50001.550

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MANDATORY SOCIAL SECURITY AND MEDICARE

- Section 218 coverage is based on the position an employee occupies, Mandatory coverage is based on an employee.
- It is important to understand that you must first determine whether the position or services are covered under a Section 218 agreement. We only apply the mandatory coverage rules when the employee's position, and therefore the employee, is not covered under the Section 218 agreement.

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COVERAGE ISSUES

- New political subdivisions formed in the state may not be compliant with Section 218 coverage rules.
- Teachers excluded from paying FICA on a state wide basis, however many of the entities have Section 218 agreements. Teachers do many other duties not considered in the definition of retirement system compensation. The FICA taxability of the extra work (example chaperoning a dance) depends on whether or not the entity has an exclusion for part time work.

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COVERAGE ISSUES

- Political subdivision stops withholding social security on their employees after implementing a qualified, alternative retirement plan. However, the employees of the political subdivision are covered by a Section 218 Agreement. Social security coverage under a Section 218 Agreement cannot be terminated.

For example – police and firefighters covered by a Section 218 agreement as part of an absolute coverage group later become members of a qualified, alternative retirement plan. The City erroneously stops withholding social security and Medicare from their wages.

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COVERAGE ISSUES

- A state has not executed a modification increasing the FICA exclusion threshold amount from \$100 to \$1,500 for election workers.

The state's cities and counties were under the impression the election worker exclusion had been increased by Congress and did not withhold from the election workers.

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COVERAGE ISSUES

- Governmental entity's employees are covered by a qualified alternative retirement system
- Governmental entity does not have a Section 218 modification
- Governmental entity is erroneously withholding and paying social security on the employees' wages

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RESOURCES

Web Site links:

- **Federal, State and Local Governments** home page at: www.irs.gov/govt/fslg
- **List of FSLG Specialists:**
www.irs.gov/govt/fslg/article/0,,id=103384,00.html
- **SSA State and Local Governments** home page at: www.ssa.gov/slge
- **SSA State and Local Coverage Handbook (SL)** at: www.ssa.gov/slge/slch.htm

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RESOURCES

- **Coverage Status of Election Workers**
www.ssa.gov/slge/election_workers_2005_nov.htm
- **Coverage Status of Students** at
www.ssa.gov/slge/student_coverage_chart.htm
- **National Conference of State Social Security Administrators** home page at: www.ncsssa.org
- **List of State Social Security Administrators:**
www.ncsssa.org/statessadminmenu.html

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FSLG COMPLIANCE SELF-ASSESSMENT TOOL

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A VOLUNTARY SELF-HELP TOOL

- The FSLG Compliance Self-Assessment Tool was designed to help governmental entities conduct a self-assessment of Federal tax compliance.
- It addresses the areas of tax law that apply to most or all governmental units, especially smaller entities.

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BENEFITS OF THE TOOL

- Covers all major areas of tax law affecting governments
- Provides quick links to related educational materials.
- Allows entities to identify those areas where further assistance may be needed.

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THE TOOL COVERS SEVEN AREAS

- The FSLG Compliance Self-Assessment Tool is divided into seven topical areas. Each section provides a series of questions to quickly identify the tax issues government entities face and provides a brief explanation of the topic.
- These are the seven areas the tool covers:

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SOCIAL SECURITY

- Are some positions covered by a retirement plan and exempt from social security tax?
- Are some employees covered by social security under a Section 218 agreement with SSA or under mandatory provisions?

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MEDICARE

- Do you have employees exempt from Medicare tax? They may be exempt if they were not covered on March 31, 1986, and have been in continuous employment since then.
- Are some types of payments exempt from Medicare tax?

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RETIREMENT PLANS

- Are you complying with the contribution limits and tax-deferral rules for that type of plan?
- Do you report contributions and distributions correctly on Form W-2?

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WORKER CLASSIFICATION

- Have you applied the common-law tests to determine whether your workers are correctly classified as employees or independent contractors?
- Are your elected and appointed officials treated as employees?

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FRINGE BENEFITS

Do you correctly withhold on and report employee fringe benefits, such as:

- Use of a vehicle
- Health benefits
- Uniforms or clothing
- Travel allowances

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INTERNATIONAL ISSUES

- Do you have workers who are nonresident aliens?
- Do you withhold according to treaty provisions?

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OTHER ISSUES

- Filing correct information returns timely
- Backup withholding when required
- Filing employment tax returns timely
- Making deposits in correct amounts and on time

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WHO SHOULD COMPLETE THE TOOL

- Depending on the size and complexity of your entity, the tool may be completed by one or more reviewers
- For each question indicate "OK" or, if you recognize a potential problem, "Flag" the item for further review
- Electronic links are provided to allow access to related educational material

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FURTHER STEPS

- Contact tax advisor or FSLG Specialist
- Visit FSLG website at www.irs.gov/govt/fslg for more resources and updates

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NOTE TO USER

- The Tool is intended as a general guide to the most common issues. It does not cover every situation; you may have other tax issues not addressed here.
- The Tool should not be regarded as official advice or an IRS determination with respect to any situation. Contact the IRS or your tax advisor about specific questions.
- Visit our website (www.irs.gov/govt/fslg) for more information.

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COMMENTS

- We value your comments and would appreciate your feedback on this Webinar at:

tege.fslg.feedback@irs.gov
- If you have Federal Tax topics for Government Entities for future Webinars, please provide ideas at the above e-mail address

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