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Social Security Coverage For Local Government Employees

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The Omnibus Budget Reconciliation Act of 1990 (OBRA), passed by Congress in November 1990, placed new requirements on local governments for withholding Social Security taxes on wages paid to employees. Final regulations were issued by the U.S. Department of the Treasury and the Internal Revenue Service on June 28, 1991. These regulations affect all public sector employees who are not part of a qualified retirement plan. Because of uncertainties and questions regarding the provisions of the law, this technical bulletin offers answers on how the act affects municipal governments in Tennessee.

Requirements Prior To OBRA

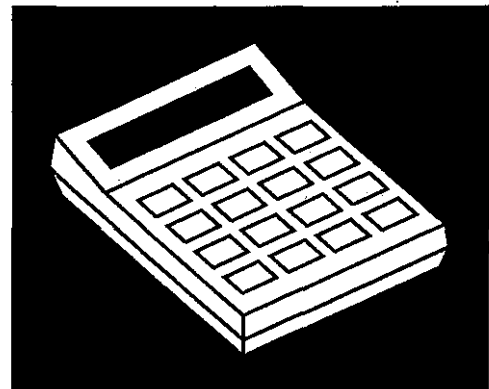
Full social security coverage includes the Old Age, Survivors, and Disability Insurance program (OASDI) and Hospital Insurance (HI) known as Medicare. The tax rates are 6.2 percent for OASDI and 1.45 percent for Medicare. The tax is applied to employee wages up to certain wage bases set by Congress. Employers are required to match the employee withholding amount. Prior to the effective date of the act, municipalities in Tennessee were required to withhold Social Security taxes at the full rate on employees covered by a section 218 agreement between the State of Tennessee and the Social Security Administration. Those employees not covered by a section 218 agreement, which were hired after March 31, 1986, were subject only to the medicare (HI) tax of 1.45 percent. Employees hired prior to April 1, 1986, were exempt from the medicare tax. For wages paid in calendar 1991, the wage base for OASDI tax is \$53,400; for HI tax the wage base is \$125,000.

Requirements After OBRA

Wages paid to employees of municipal governments after July 1, 1991, are subject to full Social Security coverage unless the employees are members of a "qualified" retirement system. This includes all employees regardless of the date they were hired. For those employees that are members of "qualified" retirement systems, the Social Security coverage which they participated in prior to July 1, 1991, will remain in effect. The key provision or factor in determining whether Social Security is mandatory for any employee is that employee's participation in a qualified retirement system.

Exemptions From Coverage

OBRA 1990 provides some exemptions from the requirements of full Social Security coverage. The mandatory coverage does not apply to services performed under the following circumstances:



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1. services by an individual hired through programs to relieve unemployment such as summer youth programs for economically disadvantaged youth. (These programs will be evaluated on a case-by-case basis by the IRS.)
2. services performed in a hospital, home, or other institution where the person performing the service is a patient or inmate thereof.
3. services by an election official or worker paid less than \$100 in a calendar year.
4. services by an individual hired temporarily to handle disaster emergencies such as fire, flood, storm, snow, or earthquake.
5. services by an individual paid on a fee basis which would qualify as net earnings from self-employment.
6. non-resident aliens with F-1, J-1, or M-1 teaching visas.

Requirements Of Qualified Retirement Systems

For purposes of the Act, a retirement system is a pension, annuity, retirement or similar fund or system established by a state or a political subdivision thereof. There are certain tests which must be met in order for a specific retirement system to "qualify" under the provisions of the regulations. These tests are applied differently for defined benefit and defined contribution arrangements.

Defined benefit plans must generally offer a meaningful benefit in comparison with any amount which could be received from Social Security's primary insurance amount. IRS Revenue Procedure 91-40 sets up minimum retirement benefits for which a plan will be considered "qualified". Defined contribution plans must generally be required to allocate at least 7.5 percent of a worker's annual compensation into the employee's retirement account. The benefits can be provided through IRS Section 457 plans, Section 403(b) tax sheltered annuities, or other defined contribution arrangements.

If your city has a retirement plan for employees but you are unsure as to whether the plan would be considered "qualified" under the new regulations, you should contact the plan provider or request a determination letter from the IRS.

Selected Questions & Answers

1. **What employees are covered under the provisions for full Social Security coverage under OBRA 1990?** All full-time, part-time, temporary, and seasonal employees that are not participating in a qualifying retirement plan made available through the employer must participate in full Social Security coverage for wages paid after July 1, 1991.
2. **What is full Social Security?** Full Social Security coverage includes both the Old Age, Survivors, and Disability Insurance (OASDI) and Hospital Insurance (HI) known as Medicare. In 1991, the first \$53,400 of employee wages are subject to the OASDI tax of 6.2 percent; the first \$125,000 of wages are subject to the HI tax of 1.45 percent. The employer must match both of these taxes.
3. **Our city has a qualified retirement plan but has a waiting period of 90 days before an employee may become a member. We currently do not have a section 218 agreement with the State of Tennessee. What Social Security coverage does an employee have if hired after July 1, 1991?** The employee would be required to participate in Social Security from the hire date to the date he becomes a member of the retirement system. At that date, full Social Security coverage would cease. Medicare taxes would continue to be paid.
4. **What are part-time, seasonal, and temporary workers?** A part-time employee works 20 hours or less per week. A seasonal employee works full-time but less than five months a year, and a temporary employee performs services under an agreement for two years or less.

5. **My jurisdiction has a Section 218 agreement for Social Security coverage. Does this agreement have to be revised and how will the new law effect our employees?** No. These agreements between public employers and the Social Security Administration provide for coverage by Social Security on a voluntary basis. The new law is mandatory, therefore revisions are not required. Your employees will continue to be subject to full Social Security coverage.
6. **Is the mandatory requirements for Medicare coverage (1.45 percent) changed in any way under the new law?** Employees hired before April 1, 1986, will be required to participate in Medicare coverage, as well as OASDI coverage, after July 1, 1991, if they are not members of a qualified retirement plan. All workers hired after April 1, 1986 continue to be subject to the Medicare tax regardless of their participation in a retirement system.
7. **How do the new rules apply to volunteer fire fighters?** If a volunteer fire fighter is paid based on a nominal set amount for each fire responded to and has no other benefits of employment, (s)he would fall under the exemption for temporary hiring of employees in the event of a disaster. Mandatory coverage would not apply. Reportable wages would go on a W-2 at year-end with no amounts reported in the boxes for federal withholding taxes or Social Security taxes.
8. **Our city has been making payments to the City Judge, Board Members, and Commission Members and not withholding taxes. We have been reporting these payments on Form 1099 at year-end. How are these payments to be reported?** All payments, regardless of amounts, made to employees, board members, and commission members which are not reimbursements for documented expenses are properly reported on Form W-2 as wages subject to Social Security and withholding taxes. If the above employees are not participants of "qualified" retirement plans, the wages would be subject to full Social Security coverage.
9. **Our city does not have a qualified retirement plan and currently does not have a section 218 agreement with the State of Tennessee. What happens if the city decides to establish a qualified retirement system after July 1, 1991?** Your city will be subject to full Social Security for wages paid after July 1, 1991. However, if your city should adopt a qualified retirement system at some time in the future, the mandatory full Social Security coverage would cease. Only the medicare portion of the tax would remain in effect.
10. **Why should our city enter into a section 218 agreement now, since mandatory Social Security coverage is required after July 1, 1991 anyway?** As stated in the answer to question 9, full coverage would automatically cease if your city adopted a qualified retirement plan. If a section 218 agreement was in place prior to the adoption of the retirement plan, no cessation of Social Security coverage would occur. Some cities began withholding full Social Security taxes prior to July 1, 1991. Even though taxes were paid to the IRS, those wages would not be covered by Social Security, unless a section 218 agreement is adopted.
11. **Our city does not have any Social Security coverage and does not have a qualified retirement plan. What procedures must we follow in order to start participating in Social Security?** If your city has been paying wages subject to federal withholding taxes, you should begin withholding Social Security taxes at the applicable rates and remit taxes to the Internal Revenue Service. Form 941 should be filed on a quarterly basis which shows wages paid and tax liability incurred. Employers who do not have an employer identification number (EIN) should request one using IRS Form SS-4. These are available from your IRS district office or a local Social Security Administration office.
12. **When do deposits of withheld taxes have to be made?** Deposit rules are found in IRS Circular E, Employers Tax Guide. Wages subject to Social Security and medicare taxes are to be reported on IRS Form 941 as stated in question 11. The timely

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deposit of these taxes, along with federal income tax withholding, is made depending upon certain threshold amounts withheld and total tax liability incurred. Form 8109, Federal Tax Deposit Coupon, should be used to deposit taxes due. In general, cumulative amounts of less than \$500 per quarter may be paid with Form 941. Cumulative amounts of over \$500 but less than \$3,000 in any one month may be deposited by the 15th day of the next month. Amounts of over \$3,000 must be deposited within 3 banking days of the date the liability is incurred. Amounts of \$100,000 or more must be deposited by the next banking day. Substantial penalties may be assessed by the IRS for failure to make timely deposits of payroll taxes or for failure to use Form 8109 if required. These are only general guidelines for deposits. You should refer to IRS Circular E for more specific instructions on tax deposit rules.

13. Our city has just realized that its employees were subject to full Social Security coverage on July 2, 1991. However, we have not taken out any taxes from employee wages paid since that date. What must we do? You should immediately determine the amount of Social Security taxes which should have been withheld since July 2, 1991. An adjustment to the employees' next payroll checks should be made to "catch up" for amounts which should have been withheld from that date or their date of employment, whichever is later. Make the required tax deposit and report the proper amounts on the next quarterly Form 941 to the IRS.

14. Our city makes payments to individuals which we consider to be independent contractors. Are these payments subject to the mandatory Social Security requirements of the new law? No. If the payments are indeed made to independent contractors, they are not considered wages and are reportable on IRS Form 1099. However, if you are not sure if a person is an employee or not, you should get a determination from the IRS by filing Form SS-8 with your IRS district office.

15. Who should we contact to enter into a section 218 agreement for Social Security coverage? Contact Ms. Mary E. Smith, Director, Old Age and Survivors Insurance Agency, Tennessee Retirement System, 1300 Andrew Jackson State Office Building, Nashville, Tennessee 37219 or call (615) 741-7902.

For Further Information

If you have questions regarding OBRA, contact Ms. Mary E. Smith, Tennessee Treasury Department at (615) 741-7902. You can also contact your local MTAS finance consultants: Dick Phebus in Martin at (901) 587-7055; Ken Joines in Knoxville at (615) 974-0411; or Jim Leuty in Nashville at (615) 256-8141.

The Municipal Technical Advisory Service (MTAS) is a statewide agency of The University of Tennessee's Institute for Public Service. MTAS operates in cooperation with the Tennessee Municipal League in providing technical assistance services to officials of Tennessee's incorporated municipalities. Assistance is offered in areas such as accounting, administration, finance, public works, communications, ordinance codification, and waste-water management.

MTAS *Technical Bulletins* are information briefs that provide a timely review of topics of interest to Tennessee municipal officials. *Bulletins* are free to Tennessee local, state, and federal government officials and are available to others for \$2 each. Contact MTAS for a list of recent *Bulletins*.

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