DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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The Honorable Jeff Bingaman
United States Senator
105 West Third Street, Suite 409
Roswell, New Mexico 88201

Attention:

Dear Senator Bingaman:

This letter is in response to your inquiry, dated August 30, 2006, made on behalf of
.
seeks information on the social security coverage of employees, and asks whether will be responsible for taxes under the Federal Insurance Contributions Act (FICA) incurred before the effective date of the Section 218 Agreement between the State of and the Social Security Administration (SSA).

Although we cannot provide an opinion on 's liability for FICA taxes, we can provide you with information about FICA taxes and factors that may affect whether has any liability for periods prior to when coverage began for certain of its employees under the Section 218 Agreement.

FICA Taxes

FICA taxes are composed of the Old-Age, Survivors, and Disability Insurance taxes, also known as social security taxes, and the hospital insurance tax, also known as Medicare taxes. Generally, all payments of remuneration by an employer for services an employee performs are subject to FICA taxes, unless the law specifically exempts the payments from the term "wages" or the services from the term "employment." The Internal Revenue Code (Code) defines those terms in Sections 3121(a) and (b), respectively.

The law generally excludes from "employment" services individuals perform in the employ of any state, political subdivision, or wholly-owned instrumentality of the foregoing. However, the exception from employment does not apply to services

included under a "218 agreement" [Section 3121(b)(7)(E) of the Code]. A 218 agreement is a voluntary agreement between a state and the SSA to provide social security coverage for employees of states or local governments within the state.

Since 1991 if the services state or local government employees perform are not included under a section 218 agreement, the exception from employment will not apply to them unless they are members of the retirement system of a state, political subdivision, or wholly owned instrumentality [Code Section 3121(b)(7)(F)]. Thus, if 's employees were not members of a retirement system prior to the date on which coverage under the 218 Agreement took effect, their wages for services performed between July 2, 1991 and the effective date of the 218 Agreement would have been subject to FICA taxes. Whether a retirement arrangement is a retirement system within the meaning of Code Section 3121(b)(7)(F) generally depends on whether the retirement arrangement provides benefits equivalent to social security benefits. If a taxpayer wants a ruling that its retirement arrangement is a retirement system for FICA purposes, the taxpayer may request a private letter ruling. Revenue Procedure 2006-1, 2006-1 I.R.B. 1, provides instructions for the submission of private letter ruling requests by taxpayers.

If the employees are members of a retirement system of , a political subdivision of or wholly owned instrumentality of or a local government within the meaning of the regulations and, therefore, exempt from FICA under Code Section 3121(b)(7)(F), they may still be subject to the Medicare portion of the FICA taxes. All state or local government employees hired after March 31, 1986 are subject to the Medicare portion of FICA regardless of membership in an employer's retirement system [Section 3121(u)(2)(C) of the Code].

Section 218 Agreements

The Social Security Act provides the statutory provision that allows state and local governments to voluntarily extend social security coverage to their employees under Section 218 agreements [42 United States Code (USC) Section 418]. These agreements provide the basic definitions, provisions, and conditions for voluntary Social Security and/or Medicare coverage for public employees. They may be amended through written agreements called "modifications." These modifications usually correct errors or provide additional coverage.

Generally, Section 218 agreements and modifications are effective for services performed after the effective date specified in the agreement or modification. See 42 U.S.C. Section 418(e)(1). The designated effective date cannot be earlier than the sixth calendar year before the year in which the state mails or delivers the Section 218 agreement or modification to the SSA [See 42 U.S.C. Sections 418(e)(1) and Section 418(e)(2). See also, 20 Code of Federal Regulations (CFR) Section 404.1214, 20 CFR

§404.1215.] Section 218 agreements in effect on or after April 20, 1983, are generally permanent and cannot be terminated. See 42 USC Section 418(f).

The date on which coverage under a Section 218 agreement or modification takes effect is determined in the negotiations between SSA and the applicable State and captured in the agreement or modification. Entry into a Section 218 Agreement or a modification does not trigger liability for social security taxes on wages paid to employees for periods prior to the time their coverage begins under the Section 218 Agreement. However, if the employees were not members of a retirement system prior to the time that their coverage begins under the Section 218 Agreement, then their wages would have been subject to social security taxes for those prior years reaching back to 1991. Years prior to 2003 are very likely closed under the statute of limitations if has filed Form 941 reporting wages and liability for Medicare tax as would have been due and owing on employees hired after March 31, 1986, irrespective of whether they were covered by a retirement system.

Although this letter is not a ruling, I hope the information provided above is helpful. If you have any questions, please contact me at ( ) , or or at ( ) .

Sincerely,

Catherine E. Livingston
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