DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF THE CHIEF COUNSEL

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The Honorable John Kerry
United States Senator
One Bowdoin Square
Boston, MA 02114

Attention:

Dear Senator Kerry:

This letter responds to your inquiry dated August 17, 2012, on behalf of your constituent, . stated that the School District absorbed all of the school employees that the formerly employed. These employees became School District employees and received payment under its tax identification number. asked whether the former employees of the hired before April 1, 1986, remain exempt from Medicare tax under the "continuing employment exception" because they continue to work for the same employer.

As a general matter, apart from the procedure for issuing a private letter ruling, as described in Revenue Procedure 2012-1, 2012-1 I.R.B. 1, the IRS cannot provide binding legal advice applicable to particular taxpayers. If wishes to request a private letter ruling, he should follow the procedures found in Rev. Proc. 2012-1. In the interim, we provide the following general information.

Taxes under the Federal Insurance Contributions Act (FICA) consist of an old-age, survivors, and disability (OASDI or social security) portion and a hospital insurance (Medicare) portion. FICA taxes are computed as a percentage of "wages" an employer paid and the employee received for "employment." In general, all employer payments of remuneration for services performed by an employee are subject to FICA taxes, unless

the payments are specifically excepted from the term “wages” or the services are specifically excepted from the term “employment.”

For FICA purposes, employment includes services performed after July 1, 1991, by an employee of a state, political subdivision, or instrumentality of the state or political subdivision unless the employee is a member of a qualified retirement system. [section 3121(b)(7)(F) of the Internal Revenue Code (Code)]. However, the services are not employment for the Medicare portion of FICA if the services are performed by employees hired before April 1, 1986, provided that the employee:

- Was performing regular and substantial services for pay before that date,
- Was employed in good faith before that date,
- Was hired for purposes other than avoiding Medicare taxes, and
- Had not at any time on of after that date experienced a termination of the employment relationship with the employer [section 3121(u)(2)(C) of the Code].

Revenue Ruling 86-88, 1986-2 C.B. 172 provides guidelines on the applicability of this exception, termed the “continuing employment exception,” to political subdivision employees in various situations. Under Rev. Rul. 86-88 the term “political subdivision” has the same meaning that it has under section 218(b)(2) of the Social Security Act, Title 42 of the United States Code, section 418(b)(2). Thus, the term “political subdivision” ordinarily includes a county, city, town, village, or school district. Under this definition, if an employee ceased to work for one school district and began to work for another, he or she would have transferred from one political subdivision employer to another political subdivision employer and would no longer meet the continuing employment exception. See Q/A 7 of Rev. Rul 86-88.

However, *Board of Education of Muhlenberg County v. United States*, 920 F. 2d 370 (6th Cir. 1990), found that the Code does not explicitly address the application of the continuing employment exception in cases of merger or consolidation of entities. Under this case, three formerly independent school districts merged into one consolidated school district. The court held that the new school district was not a new employer for purposes of the continuing employment exception. The court turned to the legislative history to determine that the purpose of Code section 3121(u)(2)(C) was to protect state and local government entities from a sudden increase in Medicare taxes (H.R. Rep. No. 99-241, 99th Cong. 1st Sess., Pt. 1 at 25-27). The court concluded that the Congress did not intend to treat a merger or consolidation of two or more employers as creating a new employer for purposes of Code section 3121(u)(2)(C) because such treatment would create the same sudden financial burden on state and local governments that the Congress intended to mitigate and would deter consolidation of local government entities for purposes of enhancing efficiency. Accordingly, the court held that the taxpayer was not a new employer for its post-merger employees, who in substance worked continuously for the same employer under a different name.

A district court reached a similar conclusion in *Regan v. United States*, 421 F. Supp. 2d 319 (D. Mass. 2006), a case involving the transfer of employees from a political subdivision to the state. In this case, Massachusetts abolished most of the county government in seven counties and certain employees of the abolished counties became state employees. The court held that the state of Massachusetts was not a new employer, and the employees remained eligible for the continuing employment exception.

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2012-1, section 2.04.

I hope this information is helpful. If you have additional questions, please contact me at or at .

Sincerely,

Victoria A. Judson
Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)