



Social Security Coverage and Reporting

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...leading the way

Are your elected officials covered?

Some political subdivisions, when they entered into a Section 218 Agreement, excluded their “elective” positions from Social Security. However, many political subdivisions like cities and counties have had several payroll officers come and go since the original agreement and may not be familiar with this possible exclusion. There are important regulations and laws that a payroll officer should know.

For example, City X has an “elective exclusion” in their Section 218 Agreement. This means that you would not withhold social security tax from any elective position **if the elective individual is a participant in the City’s Retirement System.**

Specifically, if the City is participating in CERS and the mayor is a member of the CERS, then you would not withhold Social Security (6.2%) and he/she would not match (6.2%) from his earnings. (However, you would continue employer/employee matching in Medicare (1.45%) if he/she was elected after March 1, 1986).

If the mayor does not participate in the Retirement System, then the full FICA (7.65%) would be matched for employer/employee matching because of the Mandatory FICA rules of 1991.

If the mayor does participate in the retirement system, and the city has been withholding full FICA then there are two options:

- 1) Stop the employer/employee matching of the Social Security (6.2%) and then retrieve the money paid in up to the statutory limits. If the city chooses this route, it is important to note that the employee (mayor) could be affected by the Government Pension Offset or Windfall Elimination Provision upon retirement. Also, the mayor could eventually lose disability benefits within Social Security. All of this will depend on an individual by individual basis.
- 2) If city and mayor want to continue paying into Social Security, then the Division of Local Government Services in cooperation with the political subdivision would begin the process of modifying your original agreement to include the “elective” positions.

If your political subdivision is unsure of your Section 218 coverage or the meaning of your coverage, you can contact James Driver at 502-564-3952 or by email at james.driver@ky.gov.

FICA REPLACEMENT PLANS

From time to time we get questions on how an individual could participate in a FICA Replacement Plan. Though it should be noted that only an IRS FSLG Specialist can determine whether an individual can participate, the following information provides a guideline for public employer's to consider. The information below was presented at the 2006 National Conference of State Social Security Administrators by IRS FSLG Specialist Kevin MacKessey.

For an individual to be eligible for a FICA Replacement Plan the individual must be employed by a public employer. And the proper determination must be based on employee to employee situation. The individual can not be covered by a Section 218 Agreement. If they are covered under a 218 agreement, then the individual can not participate in a FICA Replacement Plan.

The individual must be employed by an employer that maintains a retirement system that satisfies the minimum benefit requirements. According to the Treasury Regulation 31.3121(b)(7) – 2(e)(2), a retirement plan must provide a retirement benefit comparable to social security. The Regulations mention the following: Defined Contribution Plan and Defined Benefit Plan.

Defined Contribution of at least 7.5% is required of the employee's compensation. The employee's compensation must be at least base pay and the contribution must earn at least a reasonable rate of interest or credit with actual earnings. In short, an investment account with a rate of return. The plan requires the employee to contribute 5% of their base pay and the employer to match 1% for the first 1% and ½% for each additional percent each pay period. The employee will earn 5% interest on contributions.

For example: An employee contribution = 5% and the employer contribution = 1% + 2% = 3%. This would meet the minimum benefit requirement since the total contribution rate is 8% of base salary.

The Defined Benefit Plan must meet the minimum benefit requirements as outlined in Revenue Procedure 91-40 section 3.01 through Average Period Factor. The Benefit must begin no later than age 65. Compensation must be no less inclusive than employee's base pay.

The individual, whether in Defined Contribution or Defined Benefit Plan, must be the entity's Common Law employee. Common Law employees are subject to Social Security and plan participants must be employees of the entity.

The individual must be a Qualified Participant. The Defined Benefit Qualifier must meet all the conditions (other than vesting) set forth in the plan, such as: minimum age, minimum period of service, make an election to participate, make employee contributions, and be present at the end of the plan year. The Defined Contribution Qualifier must on any given day be an individual who has satisfied all conditions (other than vesting) for receiving an allocation to their account (exclusive to earnings). As an example, the employee must be employed on the last day of the plan year in order to receive any allocation for the year. The employee's are not qualified participants before the last day of the plan year.

In summary, an individual must meet each test:

- Employed by a governmental entity
- Can not be covered by a Section 218 Agreement
- Participate in a Retirement Plan that satisfies the minimum benefit requirement
- Be a qualified participant in the Retirement Plan

The Commonwealth of Kentucky does not discriminate on the basis of race, color, national origin, sex, religion, age or disability in employment or the providing of services and will provide, upon request, reasonable accommodation including auxiliary aids and services necessary to afford individuals with disabilities an equal opportunity to participate in all programs and activities.

Election Workers Excluded from Some W-2 Reporting

Kentucky election workers who receive less than \$600 per year for their services are generally not required to have these earnings reported to the Internal Revenue Service by their county. Revenue Ruling 2000-6 provides guidance concerning the tax reporting requirements for wages paid election workers.

Wages paid for election worker services are not subject to federal income tax withholding according to IRS regulation §31.3401(a)-(b)(2). Wages paid election workers are not subject to FICA (neither social security nor Medicare) if the remuneration paid is less than an established threshold (\$1,300 in 2006) according to section 218(c)(8) of the Social Security Act.

KRS 141.010 excludes income earned by precinct workers from gross income for state income tax purposes. Various KRS sections also prohibit the imposition of a license fee or occupational tax against election worker income. Section 6041(a) of the Internal Revenue Code and the regulations there under, is the applicable section for information return reporting requirements for election workers.

There is no reporting requirement with respect to an election worker who is paid less than \$600 per calendar year. The wages are, however, reportable on Form W-2 if the election worker is paid \$600 or more. Annual wages of \$1,300 or more in 2006 are subject to FICA withholding and Form W-2 reporting but not federal income tax withholding. NOTE: Special rules apply if a regular county employee also serves as an election worker. Contact the Division of Local Government Services for details.

The applicable laws, withholding and reporting requirements are illustrated in the following examples:

- 1) An election worker is paid \$599 in 2006.
 - No FICA, federal income, state income or local occupational tax withholding is required and no Form W-2 is required.

- 2) An election worker is paid \$1,299 in 2006.
 - No FICA, federal income, state income or local occupational tax withholding is required, but a Form W-2 will be issued reflecting \$1,299 in box 1 (Wages, tips and other compensation).
- 3) An election worker is paid \$1,300 in 2006.
 - FICA withholding is required, but no federal income, state income or local occupational tax is withheld. The election worker will be issued a Form W-2 reflecting \$1,300 in boxes 1, 3 and 5 and the appropriate FICA tax withholding in boxes 4 and 6.

Distinguished Educator Program

The distinguished educator who is paid both the regular salary and the Distinguished Educator Salary Supplement by the home school district and who is a qualified participant in KTRS for the regular salary is excluded, for both wage payments, from the social security portion of the FICA tax. These wages would be subject to the Medicare portion of the FICA tax unless the continuing employment exception applies.

This guidance—provided by the IRS—is based on the premise that the educator is performing services in a KTRS position not covered under the Section 218 agreement, that the KTRS is a qualified retirement system under IRC 3121(b)(7)(F) and that the home school district is the employer.

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Government Employer Tax Sheet

As IRS compliance activity increases with Government Employers, we in the Office of Local Government Services are coming out to the different political subdivisions and offering a quick Government Employer Tax Sheet and informational. Usually the time spent with each agency is approximately an hour to two hours depending on the questions and various scenarios each agency faces.

As of the end of August 2006, we will have been to 16 County Governments and conducted training for the Kentucky Municipals Clerks Institute. We are currently scheduled for other conferences and have several county and city governments scheduled.

The goal is to simply make sure each local government agency is ready should an IRS compliance check occur. The Government Employer Tax Sheet is an opportunity for us to share with you what the IRS will be looking for and how to be prepared. We will cover the employment tax issues that IRS tells us are hot button issues in compliance activity.

Note: We do not look at your employment records and we do not ask for any confidential information. In fact, we do not ask to see anything. We are simply sharing information that the IRS has shared with us.

If you would be ready for your employment tax checkup, you can contact James Driver at james.driver@ky.gov or call 502-564-3952.