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State Government Edition

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Social Security Coverage Review

Prior to 1951 Social Security coverage for government employees was not available. On January 1, 1951, federal law changes allowed voluntary Social Security coverage for the employees of state governments and their political subdivisions through an agreement between the federal government and each state. As the legal provisions for such an agreement is included in Section 218 of the Social Security Act, it is referred to as a "Section 218 Agreement".

In the beginning, Social Security for public employees was limited to those employed in positions not covered by a retirement system. The employer had only to negotiate a Section 218 Agreement with the Commonwealth to provide Social Security coverage. The Social Security Act was amended in 1954 to allow Social Security coverage for public employees in positions covered by a retirement system.

Kentucky's political subdivisions provide Social Security coverage by entering into a Section 218 Agreement with the Division of Social Security.

Need Help? The DOSS has the Cure!

The Division of Social Security has the resources and contacts to help with most social security coverage and reporting problems encountered by Kentucky state agencies.

The DOSS has information packets covering such issues as:

- * Who's a government employee;
- * Employer-provided vehicles;
- * Reporting third party sick pay;
- * FICA & cafeteria benefit plans;
- * Medicare only for workers; and
- * Social security benefits for workers.

These are available at no charge upon request.

We also are in regular contact with Social Security Administration and Internal Revenue Service officials who keep us informed on the latest information from the federal government.

Feel free to contact the DOSS if you have any questions about social security coverage and reporting for state agencies.

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Once a Section 218 Agreement is signed with the political subdivision, the Commonwealth's master agreement with the Federal government is modified to include the new entity and its coverage groups.

Once a Section 218 Agreement is enacted, any services performed by an employee will be covered for Social Security purposes, unless specifically excluded in the agreement. The employee and the employer will begin paying contributions equivalent to the employee/employer share of FICA taxes and the employee will begin accruing Social Security benefits.

The term "political subdivision" includes not only cities, counties and boards of education, but also libraries, housing authorities, water districts, fire protection districts, airport boards, conservation districts, park boards, etc. Generally, if an entity is created by an act of the legislature, by a vote of the

public or by another political entity it is a political subdivision.

If a political subdivision desires Social Security coverage for its employees who are covered by a qualified retirement system, a referendum

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must first be conducted to determine if the employees want the coverage. Federal law requires the Governor of the Commonwealth (or his designee) to certify that certain minimum conditions concerning the referendum have been satisfied.

Social Security coverage is extended by "coverage groups" and cannot be extended to individual employees. Coverage groups must be distinct and easily defined. Two examples: 1) A city elects to cover the services of all its employees except those in elective positions. 2) The Commonwealth of Kentucky provides coverage for services performed by state employees except those who are members of the Kentucky Teachers Retirement System.

Employers can designate certain groups as optional exclusions to Social Security coverage in their Section 218 Agreement. These exclusions have to be included in the Section 218 Agreement at the time of its ratification. The agreement cannot be modified to add an exclusion at a later date, but an exclusion may be withdrawn and coverage extended to services performed in these positions.

Social Security coverage may not be terminated once coverage is enacted under a Section 218 Agreement. Social Security coverage continues under a Section 218 Agreement even if the services are, at a later date, covered by a retirement system. For example, in 1990, a city with employees who had no retirement coverage entered into a Section 218 Agreement with the DOSS to provide Social Security coverage to its employees. The Social Security coverage continued after the city provided a retirement system to its employees in 1995.

There are also universal exclusions from FICA applied for:

(1) positions under work relief and other programs designed strictly to relieve unemployment,

(2) payments for services performed by inmates or patients in a hospital, home or institution and

(3) election officials and election workers paid less than \$1,000 during a calendar year.

(4) Kentucky also has a statewide exclusion for services performed on a temporary, emergency basis (something of short duration that could not be foreseen), such as flood, fire, earthquake, storm, snow or other similar emergency.

Withholding under the Federal Insurance Contribution Act (FICA) falls into two categories—Social Security and Medicare. Initially, withholdings were for Social Security only, then Medicare was added in 1965. In a fundamental policy shift of historic proportion regarding voluntary participation by the states, Medicare was made mandatory for all employees hired after March 31, 1986, who do not have full-FICA coverage (both Social Security and Medicare) under a Section 218 Agreement.

Optional Medicare only coverage may be provided to certain employees via identical referendum procedures described above for Social Security coverage. This option is available only to employees whose positions are not covered by a Section 218 Agreement, who were hired prior to April 1, 1986 and who are participating members of a qualified retirement system.

In a further erosion of the voluntary coverage concept, the federal government now requires all state and local government employees who are not covered under a Section 218 Agreement and who are not participating members of a qualified retirement system (as defined in Section 3121 of the Internal Revenue Code and its regulations) be provided with Social Security and Medicare coverage for services performed after July 1, 1991. This is referred to as "mandatory FICA."

Mandatory FICA does not supercede a Section 218 Agreement, but it may require services performed in positions excluded by the Section 218 Agreement to be placed under Social Security coverage. For example, a city has a Section 218 Agreement which excluded elected positions, such as the mayor, from Social Security coverage. Under the rules of mandatory FICA, if those individuals holding the elected positions are not participating members of an employer-provided (city-provided) qualified retirement system, employee and employer FICA contributions must be withheld, regardless of any exclusion included in the city's Section 218 Agreement.

Also, under mandatory FICA, substitute and part-time teachers must contribute to Social Security and Medicare if they are not members of a Board of Education-sponsored, qualified retirement system, even though their full-time counterparts are excluded because of their participation in the KTRS. Substitute and part-time teachers may be excluded from Social Security if they are receiving KTRS retirement benefits and meet the IRS definition of a "rehired annuitant".

Standard Mileage Rates for 1996 Announced

The Internal Revenue Service has provided updated optional standard mileage rates for use in computing the deductible costs of operating a passenger car for business, charitable, medical or moving expense purposes. The new rates applies to costs paid or incurred in 1996.

The standard mileage rate for cars used in a business has been increased to 31 cents per mile for all miles of business use. The standard mileage rate for moving expenses rose to ten cents per mile. Charitable use remains at 12 cents per mile.

Employees must substantiate and adequately account for business expenses where employers use any per mile rate when reimbursing employees for the business use of a vehicle. In addition to the standard mileage rate, employees may deduct the related portion of parking fees.

Earnings Limit Increased for Working Beneficiaries

Social security benefit recipients age 65 or older—but not yet 70—and still working will be able to earn more money without seeing a reduction in benefit payments. A new law, signed March 29 of this year, increases the annual earnings limit, gradually raising it to \$30,000 by 2002. This year the recipient can earn \$12,500 before the benefits are reduced \$1 for every \$3 in earnings.

In 1997, the annual earnings limit will be \$13,500; in 1998, \$14,500; in 1999, \$15,500; in 2000, \$17,000; in 2001, \$25,000 and in 2002, \$30,000. After 2002, the annual exempt amount will be indexed to growth in average wages. The new law does not change the earnings limit for workers under age 65. There is no limit for people age 70 and older.

Only wages count toward social security earnings limits, and the self-employed consider only the net earnings. Also, investment earnings, interest, pensions, annuities, capital gains and other government benefits are not included.

Cents-Per-Mile Rule Sees Fair Market Value Increase for “Luxury” Vehicles

The cents-per-mile rule is one of the optional methods used to determine the value of the taxable fringe benefit of an employer-provided vehicle. Under this method, the value of personal use is found by multiplying the number of personal miles by the standard business mileage rate—31 cents per mile for 1996.

This rule may not be used for “luxury” vehicles, however. For vehicles first made available for employees’ personal use in 1996, the Internal Revenue Service has defined a “luxury” car as one with a fair market value in excess of \$15,400 (indexed annually), up from the 1995 level of \$15,200.

IRS Material to Aid in Determining Contractor/Employee Status Available

The Internal Revenue Service has developed new training material for tax examiners handling worker classification cases—that is, whether a worker is considered an employee or an independent contractor. This material is also available to employers.

At the 1995 White House Conference on Small Business and at a number of town meetings with small business owners sponsored by the IRS, participants identified worker classification as a major concern.

The training material covers the factors under common law that may indicate the existence of an employer/employee relationship and offers guides as to which of those factors are relevant in particular cases. They also address the factors necessary to determine whether state and local government workers are employees and emphasize that factors may change as business relationships and the work environment may change.

Copies of the material are available from:
Douglas Izard Dean
IRS School of Taxation M:CE:TX
2221 South Arlington St.
Arlington, VA 22202

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.

SS Retirement Benefits Overview

Benefits available from Social Security fall into three categories--retirement, disability and survivors. The DOSS, in an effort to explain the general details of these benefit groups, will begin with the retirement benefits in this issue. Disability and survivors benefits will be addressed in future issues. Employers may want to provide copies of this information to covered employees.

Many wonder where their social security tax dollars go. Generally, out of every dollar paid:

- * 69 cents goes to a trust fund that pays monthly benefits to retirees and their families and to widows, widowers and children of deceased workers;
- * 19 cents goes to a trust fund that pays for the health care of all medicare beneficiaries; and
- * 12 cents goes to a trust fund that pays benefits to people with disabilities and their families.

The administration of social security programs are paid from the trust funds and costs only about one penny of every social security tax dollar collected. Money not used to pay benefits and administrative expenses is invested in U.S. government bonds, one of the safest of all investments.

Social security's board of trustees reports on the financial status of the social security program each year. These reports are valuable tools for evaluating and ensuring the economic health of the social security system. The latest report indicated that social security, as currently structured, will be able to pay benefits well in to the next century.

Workers who pay social security taxes can earn a maximum of four social security credits per year. The number of credits needed to be eligible for retirement benefits depend on the worker's birth date. Those born in 1929 or later need a lifetime total of 40 credits. People born before 1929 fewer credits—39 if born in 1928, 38 if born in 1927, etc. No retirement benefits can be paid until the required number of credits are earned. Extra credits do not increase the social security benefit.

If a person stops earning social security credits before amassing enough to qualify for benefits, they will remain on that person's social security record. Then, should the person return to a position covered for social security purposes, the additional credits will be added to the amount previously earned.

A worker's benefit amount is based on the earnings averaged over most of the worker's working career. Higher lifetime earnings equal higher benefits. The benefit amount is also affected by the age at which a worker starts receiving benefits. Age 62 is the earliest retirement benefits may be collected, but they will be lower than if the worker waited until a later age. Social security law also provides for automatic cost-of-living increases.

The usual retirement age is about 65. Social security calls this "full retirement age," and the benefit amount that is payable is considered the full retirement benefit. Because of longer life expectancies, the full retirement age will be increased in gradual steps, beginning in 2003, until it reaches age 67. This effects people born in 1938 or later.

A retiree can start receiving social security retirement benefits as early as age 62, but the benefit amount will be less than the full retirement benefit. If early retirement is taken, the benefits will be permanently reduced based on the number of months a retiree will receive benefits before reaching full retirement age. If the worker's full retirement age is 65, the reduction for receiving benefits at 62 is about 20 percent; at age 63 the benefits are reduced about 13 percent, at 64 about seven percent.

As a general rule, early retirement will provide about the same total of social security retirement benefits, but in smaller amounts to account for the longer benefit payment period.

Not everyone retires immediately upon reaching full retirement age. In that case social security benefits may be increased in two ways:

- * Each additional earning year adds another year of earnings the worker's social security record. Higher lifetime earnings may result in higher benefit when the worker does decide to retire.
- * Retirement benefits will be increased by a certain percentage if retirement is delayed beyond the full retirement age. The increases are added automatically from the time the worker reaches full retirement age until the worker begins accepting retirement benefits or reaches age 70.

If a worker plans to begin retirement after age 62, it is a good idea to contact the Social Security Administration in advance to see which month is best to claim benefits. In some the choice of retirement month could mean additional benefits. It may be an advantage to have social security retirement benefits begin in January, even if the worker doesn't plan to retire until later in the year.

If a person is not working, or a person's annual earnings are under the SSA's earnings limit, or a person plans to start collecting social security retirement benefits upon reaching age 62, application for benefits should be made three months prior to the date the person wants them to begin. Because of the complicated rules, people are urged to discuss retirement plans with a social security claims representative in the year before the retirement date.

More information about social security retirement benefits can be obtained by calling 1 (800) 772-1213 or by contacting your district social security office.