

**Joint Hearing on the Complexities and Challenges
of Social Security Coverage and Payroll Tax
Compliance for State and Local Governments**

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

AND

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTEENTH CONGRESS

FIRST SESSION

JUNE 29, 2017

Serial No. 115-SS04

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Joint Hearing on the Complexities and Challenges of Social Security Coverage and Payroll Tax Compliance for State and Local Governments

U.S. House of Representatives,
Subcommittee on Social Security and Subcommittee on Oversight,
Committee on Ways and Means,
Washington, D.C

WITNESSES

Marianna LaCanfora

Acting Deputy Commissioner, Office of Retirement and Disability Policy, Social Security Administration
Witness Statement

Sunita Lough

Commissioner, Tax Exempt and Government Entities Division
Witness Statement

Maryann Motza, Ph.D.

Legislative Committee Chair and Past President, National Conference of State Social Security Administrators
Witness Statement



WAYS AND MEANS

CHAIRMAN KEVIN BRADY

Chairman Johnson and Chairman Buchanan Announce Joint Hearing on the Complexities and Challenges of Social Security Coverage and Payroll Tax Compliance for State and Local Governments

House Ways and Means Social Security Subcommittee Chairman Sam Johnson (R-TX) and Oversight Subcommittee Chairman Vern Buchanan (R-FL) announced today that the Subcommittees will hold a joint hearing, entitled “Complexities and Challenges of Social Security Coverage and Payroll Tax Compliance for State and Local Governments.” Section 218 of the Social Security Act allows state and local governments to extend Social Security coverage to their employees through a voluntary agreement with the Social Security Administration. The hearing will focus on the complexity of Social Security coverage and payroll tax compliance under Section 218. Members will also discuss the responsibilities of the Social Security Administration, the Internal Revenue Service, and State Social Security Administrators in ensuring proper administration. **The hearing will take place on Thursday, June 29, 2017 in 1100 Longworth House Office Building, beginning at 10:00 AM.**

In view of the limited time to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select “Hearings.” Select the hearing for which you would like to make a submission, and click on the link entitled, “Click here to provide a submission for the record.” Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Thursday, July 13, 2017.** For questions, or if you encounter technical problems, please call (202) 225-3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available at <http://www.waysandmeans.house.gov/>

COMPLEXITIES AND CHALLENGES OF SOCIAL SECURITY
COVERAGE AND PAYROLL TAX COMPLIANCE FOR
STATE AND LOCAL GOVERNMENTS

Thursday, June 29, 2017

House of Representatives,

Subcommittee on Social Security,

joint with the

Subcommittee on Oversight,

Committee on Ways and Means,

Washington, D.C.

The subcommittees met, pursuant to call, at 10:00 a.m., in Room 1100, Longworth House Office Building, Hon. Sam Johnson [chairman of the Subcommittee on Social Security] presiding.

Chairman Johnson. Good morning, and welcome to today's hearing on the complexities and challenges of ensuring Social Security coverage and payroll tax compliance for State and local government employees.

Before we begin, I would like to take a moment to say a few words about my friend and former Social Security Subcommittee Chairman Jim Bunning. You remember him?

Mr. Larson. Absolutely.

Chairman Johnson. Sadly, Jim passed away just a few weeks ago. Chairman Bunning was a member of the Ways and Means Committee for four Congresses, and he chaired this Subcommittee. While many will remember Chairman Bunning as a baseball Hall of Famer -- who pitched two no-hitters, by the way -- I will always remember him as the guy who showed me the ropes on serving as Chairman on Social Security.

Among many other bills, he introduced the Rehabilitation and Return to Work Opportunity Act of 1996, that ultimately became the basis of the Ticket to Work Act of 1999.

More than 20 years later, this Subcommittee continues to look for ways to help those beneficiaries who can return to work. And I look forward to having another hearing on that topic later this year.

Jim Bunning was a patriot, a strong supporter of Social Security, and a friend. We are thankful for his service and keep his wife, Mary, and all his family in our prayers.

Turning back to today's hearing, usually when we talk about State and local workers and Social Security, we talk about how many of them aren't covered by Social Security. But today we are going to focus on the close to three-quarters of State and local workers who are covered and figuring out why their Social Security coverage and payroll tax compliance is so complicated.

When Social Security was created, State and local government employees were excluded due to constitutional concerns. Over time the law was changed to allow State and local governments to extend Social Security coverage to their employees. Today, all States have at least some employees who are covered by Social Security and pay Social Security taxes on their earnings. But who is covered can vary by State and even locality.

With all this complexity, it is up to Social Security, the IRS, and the States to work together to get it right. But as we will hear, that doesn't always happen.

Back in 2010, the Government Accountability Office found that both Social Security and the IRS have trouble identifying problems with Social Security coverage for State and local government employees and, instead, must rely on public employers to ensure compliance. Not much has changed, has it?

Social Security still does not have the ability to verify that State and local governments are properly reporting wages for covered workers, and the IRS still doesn't know whether the employer has reported and paid the correct amount of payroll tax without doing an audit. Even though payroll taxes are the biggest tax most people pay, efforts to improve compliance generally focus on other taxes.

These problems, like the one in Missouri that we will hear about today, can go undetected for years and have real consequences for Americans' retirement

security and for Social Security's Trust Funds. If someone thinks they are covered, but aren't, according to Social Security they may not qualify for the Social Security benefits that they have been counting on. And if an individual receives benefits without having paid the correct amount of Social Security tax, the Social Security Trust Funds and taxpayers are left to make up the difference.

Let me be clear. The answer here isn't mandatory coverage, but Social Security and the IRS need to get their act together. At the end of the day, we need to be sure that State and local employees pay the right amount of taxes and receive the Social Security benefits they are counting on, and that the Social Security Trust Funds get the taxes that they are owed. The American people deserve nothing less.

I thank our witnesses for being here today, and I look forward to hearing their testimony.

I now recognize Mr. Larson for his opening statement.

Mr. Larson. Thank you, Mr. Chairman.

And thank you Chairman Buchanan and my distinguished colleague, Mr. Lewis.

I would like to welcome back Chairman Johnson. As often as I get to say this, I will, but to be seated at this dais between two iconic American heroes in Sam Johnson and John Lewis is in and of itself, I think for every member of this committee and the body in general, an honor to serve with perhaps two of the greatest Americans in the history of our Nation.

With that, Mr. Chairman, I am also going to renew my pledge -- or request, I would say, is better put -- to have a hearing down in Plano, Texas. Inasmuch as -- and I know you have had hearings there before -- but inasmuch as this is your last term, I only think it fitting that we have a hearing down in Plano, Texas, preferably during the winter up here, but I am not saying -- whenever you call for that.

Chairman Johnson. Thank you.

Mr. Larson. Listen, also, a sad note on Jim Bunning. I would also like to note, not of the stature of Jim Bunning, but equally important to me and many people

in the State of Connecticut, Lillian Marlow passed last evening as well. Not known to many at this dais.

She was, like so many people who work on this staff, just an extraordinary person who kept government running with her hard work and wit and dedication. And I just wanted to recognize her here today.

Social Security is important to all Americans. And as I like to say when we are out talking about it, where could you find in the private sector guaranteed retirement income that cannot be outlived, protection in the event of a career-ending disability, life insurance for families of a worker who dies, a full cost-of-living adjustment to combat the effects of inflation? Social Security is also portable and goes with you everywhere. There simply is nothing on the private sector market that can even remotely come close to touching Social Security.

Today, 94 percent of workers in the United States are covered by Social Security. They and their employers contribute to the trust fund and earn their benefits with every paycheck, with half of the contributions coming from the employee and half coming from the employer, the employer side being tax deductible. But it is the responsibility of the employer to ensure that they are in compliance with payroll taxes.

The only large group of workers that are outside Social Security are some State and local government workers who have their own pension plan in place of Social Security. About three-quarters of the State and local workers participate in Social Security, but about a quarter don't. In my own State of Connecticut, teachers have a separate retirement plan and are not participating in Social Security, but they have an alternative plan that they pay for, regardless.

The fundamental principle is one way or another, every American should have basic retirement coverage at work. Our job today is to make sure that that is the case.

For the 90,000 units of State and local government in the United States, it can be complicated sometimes to determine which employees are participating in Social Security and who pays into the State plan, as Mr. Johnson has already outlined. But when mistakes are made, workers' financial security is at stake.

That is why this hearing today is so vitally important. I thank our witnesses for being here.

It is also why we have introduced the Social Security 2100 Act, because we believe so strongly that Social Security needs to be expanded and needs to be made solvent into the next century, and so that it is there for every single American and providing the kind of benefits with the greatest efficiency.

And with that, Mr. Chairman, I will yield back my time. And, again, it is great to see you.

Chairman Johnson. Thank you. I appreciate that. Thank you very much.

Would you like to make an opening statement?

Chairman Buchanan. Yes. Thank you, Mr. Chairman.

And I also would like to comment on Jim Bunning. As a young kid growing up in Detroit, he was a hero to a lot of us. He was an incredible pitcher. And I know he served here in Congress. So I share your thoughts with him.

Good morning. I want to thank the panel for coming today and I look forward to the hearing. I also want to thank Chairman Johnson for his important oversight work.

Today we are looking to better understand the challenge that state and local governments face when applying Social Security coverage to their workers. While many states and local government workers rely on their own retirement plans, others rely on Social Security through voluntary arrangements between the state and the Social Security Administration.

Giving states flexibility on coverage decisions is important. However, it often leads to complication, individual coverage situations for state and local employees. This creates a unique challenge for state and local employees as well as the Social Security Administration, and the IRS, who oversees these programs.

Nearly 70 percent of the \$3.3 trillion collected by the IRS comes from employment-related taxes, like those for Social Security and Medicare. These contributions must be accurate.

However, the complexity of the coverage issue for state and local governments requires a combined effort in terms of the Social Security Administration, the IRS, and the Social Security administrators to provide state and local employers with appropriate guidance and oversight.

I look forward to the hearing, and also look forward to our witnesses, so we can assist them to ensure that we better work together. Also, I would like to just add, I want to make sure that the information we get today, that we can clearly work with you.

I yield back.

Chairman Johnson. Thank you, sir.

I now recognize Mr. Lewis for any opening statement you wish to make.

Mr. Lewis. Thank you very much, Mr. Chairman.

Chairman Johnson, Chairman Buchanan, Ranking Member Larson, and fellow members, good morning. And good morning to our witnesses. Thank you for being here.

Chairman Johnson, thank you for remembering Jim Bunning. We came in the same class.

Chairman Johnson. Did you?

Mr. Lewis. In the same class. Wonderful, wonderful man. He played well, baseball well, but he played well as a Member of the House and the Senate. And our prayers go out to his family.

Every working American should have basic retirement coverage. This can be provided through Social Security or through a State's retirement system for public sector employees. These benefits help ensure that Americans maintain a basic standard of living during their retirement.

Ninety-four percent of American workers receive their basic retirement coverage through Social Security. However, about six million State and local government employees do not. These workers participate in their State's retirement system and generally include teachers, firefighters, and police officers. In my home State of Georgia, more than 180,000 State and local employees are not covered by Social Security.

State and local governments often have their own retirement system. However, these governments have the option to enter into voluntary agreements with the Social Security Administration to have their employees covered by Social Security. If a local government decides to provide coverage through Social

Security, its employees must pay Federal payroll taxes just like every other American worker.

Today's hearing will look at how Federal and State agencies work together to provide Social Security coverage to State and local government employees and ensure compliance with payroll tax requirements. We will learn from the witnesses more about how the Internal Revenue Service, the Social Security Administration, and State Administrators work together to ensure governments comply with payroll tax requirements.

I look forward to receiving recommendations from all of our witnesses on how to improve compliance. And, again, I want to thank you for being here this morning.

I yield back, Mr. Chairman.

Chairman Johnson. Thank you.

As is customary, any Member is welcome to submit a statement for the hearing record.

Before we move on to our testimony today, I want to remind our witnesses to please limit your oral statements to 5 minutes. However, without objection, all of the written testimony will be made a part of the hearing record.

We have three witnesses today. Seated at the table are Marianna LaCanfora, Acting Deputy Commissioner, Office of Retirement and Disability Policy, Social Security Administration.

Sunita Lough, Commissioner, Tax Exempt and Government Entities Division, Internal Revenue Service.

Maryann Motza, Legislative Committee chair and past president, National Conference of State Social Security Administrators.

Please proceed, Ms. LaCanfora.

**STATEMENT OF MARIANNA LACANFORA, ACTING DEPUTY
COMMISSIONER, OFFICE OF RETIREMENT AND DISABILITY
POLICY, SOCIAL SECURITY ADMINISTRATION**

Ms. LaCanfora. Chairman Johnson, Chairman Buchanan, Ranking Member Larson, Ranking Member Lewis, and members of the subcommittees, thank you for inviting me to discuss Social Security coverage for State and local employees. I am Marianna LaCanfora, Social Security's Acting Deputy Commissioner for Retirement and Disability Policy.

About 94 percent of employees in the United States are covered by Social Security. That is, they pay Federal Insurance Contributions Act, or FICA, taxes on their earnings up to a certain limit. Those earnings can qualify them and their families for benefits under our retirement, disability, and survivors insurance programs.

There are approximately 23 million State and local employees, and about one-fourth of them are not covered by Social Security. My written testimony provides the long history of coverage-related laws for this group. But in short, when Social Security was enacted in 1935, no State or local employees were covered.

Over time, Congress amended the Social Security Act to allow States to decide whether to cover employees who fall under a State retirement system, and to require coverage for those who do not. The method used by the States to establish coverage is called a 218 Agreement, after the authorizing section of the act. These Agreements specify which positions are covered.

Every State, Puerto Rico, the Virgin Islands, and 60 interstate instrumentalities have a 218 Agreement with us. Over the years, each Agreement has been modified numerous times as political subdivisions, positions, and retirement systems have been created and as groups of employees have petitioned their States to obtain Social Security coverage.

Under current law, there is tremendous variability in which positions are covered between and even within the same State. For example, if two teachers are working in the same position in the same school district, one might be covered while the other is not.

Each State and local employer is responsible for applying the terms of their State's 218 Agreement, accurately reporting earnings to SSA, and appropriately withholding FICA taxes for covered employees.

Each State has a designated State Social Security Administrator. This State official is critical in ensuring that the State get its employees' coverage status right. The Administrator performs many functions, such as being the point of

contact with the SSA and the IRS, interpreting the 218 Agreement, and educating State employers and employees. They also hold referendums and notify us of the creation or dissolution of State entities.

The IRS also plays a critical role in this process by performing compliance checks to ensure that States have appropriately withheld and remitted FICA taxes for covered employees.

Given the complexity involving State and local employee coverage, it is no surprise that employers sometimes make mistakes. SSA is committed to working closely with our State partners and the IRS to provide the tools and training that States need to get these decisions right from the start and to address issues when they arise.

I would like to highlight some of the actions SSA has taken to improve this process since GAO's last review.

We worked with the IRS to develop a tool that States can use to ensure compliance with Federal tax requirements. We designated an employee in each of our regional offices to serve as an expert and point of contact. We scanned nearly all of our agreements and modifications, including tens of thousands of pages, into a central database to allow for ease of access and search.

We modernized the system our employees use to resolve differences between the earnings reports sent to SSA and the IRS. We updated and clarified our policy guidance based on our experience and feedback from State Administrators. We developed comprehensive training materials and resources for the Administrators and provided training sessions to State and local employees.

We established standing meetings with representatives from the IRS and the National Conference of State Social Security Administrators to share information and best practices and identify challenges and solutions to issues that arise.

In addition, we recently started a project to compile and maintain lists of covered positions based on the 218 Agreements, which will be a valuable tool and quick reference for the Administrators to identify coverage issues. We are also reviewing our regulations to identify areas that we might streamline or clarify.

We remain open to ideas regarding how to further enhance our valuable relationship with the States and the IRS as we work together on these issues.

Thank you for the opportunity to describe the history and complexity of Social Security coverage for State and local employees. I would be happy to answer any questions.



HEARING BEFORE

**COMMITTEE ON WAYS AND MEANS, SUBCOMMITTEES ON
SOCIAL SECURITY AND OVERSIGHT
UNITED STATES HOUSE OF REPRESENTATIVES**

JUNE 29, 2017

**STATEMENT
OF
MARIANNA LACANFORA
ACTING DEPUTY COMMISSIONER FOR RETIREMENT AND DISABILITY POLICY
SOCIAL SECURITY ADMINISTRATION**

Chairman Johnson, Chairman Buchanan, Ranking Member Larson, Ranking Member Lewis, and Members of the Subcommittees:

Thank you for the opportunity to discuss Social Security coverage and the Social Security Administration's partnership with the Internal Revenue Service and State Social Security Administrators to provide for Social Security coverage of certain State employees while collecting commensurate Social Security taxes. My name is Marianna LaCanfora and I am SSA's Acting Deputy Commissioner for Retirement and Disability Policy.

Importance of Social Security

Social Security is a social insurance program, under which workers earn coverage for retirement, disability, and survivors' benefits by earning wages through employment or income through self-employment. Those same wages are subject to Federal Insurance Contributions Act (FICA) or Self-Employment Contributions Act (SECA) taxes.

Social Security pays monthly benefits to more than 60 million individuals, consisting of 41 million retired workers and 3 million of their spouses and children; nearly 9 million disabled workers and almost 2 million dependents; and 6 million surviving widows, children, and other dependents of deceased workers. Last year, these benefits totaled around \$905 billion. Administrative costs were less than 1 percent of benefit payments.

Coverage of Earnings for Social Security

Individuals obtain coverage for Social Security retirement, disability, and survivors' insurance benefits by establishing a history of earnings based on their wages. Wages are defined in section 209 of the Social Security Act as money paid for work or a service in an employer-employee relationship. Wages do not include payments made outside of an employment relationship, such as life insurance proceeds, tax refunds, child support payments, scholarships, proceeds from the sale of a home, court awards, royalties, unemployment benefits, public assistance, or canceled debts.

In 2017, employees and employers each pay 6.20 percent (or for self-employed individuals, the individual pays 12.40 percent) on the first \$127,200 of an employee's wages or self-employed income in Social Security taxes. If an individual's employment and earnings are covered for Social Security, he or she should pay these taxes on his or her wages.

Ninety-four percent of employees working in the United States are covered by Social Security. There are, however, exceptions to coverage for certain employees of private employers, and more commonly, for certain State and local government employees. Coverage (and coverage exceptions) are dictated by section 210 or section 218 of the Social Security Act.

Section 210 explains coverage for work performed for, among other entities, private U.S. employers and the District of Columbia. While most private work is covered, section 210 explains the exceptions to coverage for private workers (including work performed in certain

religious roles, as a Native American tribal council member, by certain students, by foreign workers, or by temporary, emergency workers).

Section 218 involves work performed for State and local government employers and explains the process by which States may request coverage for their government workers, under a Section 218 Agreement. These agreements are created at a State's discretion and, as long as they comply with relevant Federal and State laws, the Social Security Act requires the extension of Social Security coverage to the State and local government employees specified under the agreement. All 50 States, Puerto Rico, the Virgin Islands, and approximately 60 interstate instrumentalities have entered into a Section 218 Agreement with SSA.

History of Section 218

When the Social Security Act was enacted in 1935, Social Security coverage was not extended to State and local government employees due to legal questions over the Federal Government's ability to tax the States. However, because many government employers did not have their own retirement system, the Social Security Act Amendments of 1950 authorized States to enter into voluntary agreements with SSA to extend coverage to their public employees. These Section 218 Agreements originally only allowed for voluntary Social Security coverage to State and local government employees who were not covered by a retirement system. The Social Security Amendments of 1954 expanded the Act to authorize the States to extend Social Security coverage to all State and local government employees who are members of public retirement systems, if coverage group members vote in a referendum for such coverage.

The coverage provided under Section 218 Agreements varies substantially between, and within, States. When a State enters into a Section 218 Agreement, employees are brought under the agreement in coverage groups. There are two types of employee groupings for coverage purposes: absolute coverage groups, composed of positions that are not under a retirement system; and retirement system coverage groups, composed of positions that are under a retirement system. The State decides which coverage groups it would like covered and the effective date of coverage, subject to Federal and State laws, and works with SSA to formalize that coverage in the State's agreement.

Each State may have only one Section 218 Agreement, but the State may request modifications to its agreement as political subdivisions, public employment positions, and retirement systems are created, or if groups decide they would like to obtain Social Security coverage. Such modifications must meet the requirements of the Social Security Act and State laws. Additionally, if the coverage group is covered by a retirement plan, the group must first vote in a referendum for Social Security coverage.

The Social Security Amendments of 1956 authorized 23 States to divide a retirement system established by the State or instrumentality based on whether individual employees under that system desire Social Security coverage. Under the divided-vote procedures, a referendum is held for a coverage group, and the Section 218 Agreement modification provides coverage for only those members who voted for coverage, as well as all members who are newly hired after the modification goes into effect. Thus, under such a divided system, if two employees are

performing the same work in the same position for the same employer under the same retirement system, one's employment could be covered, while the other's is not.

Before 1983, a State could terminate Social Security coverage for employees covered under its Section 218 Agreement. The 1983 Social Security Amendments rescinded this provision of the Act, prohibiting States from terminating coverage. Consequently, groups of State and local government employees generally cannot have their coverage rescinded.

The Consolidated Omnibus Budget Reconciliation Act of 1985 made Social Security coverage mandatory for State and local government employees who were neither covered under a Section 218 Agreement nor members of a public retirement system (that offers, at a minimum, retirement benefits comparable to those provided by Social Security), beginning July 2, 1991.

The change of laws and the flexibility that the laws have provided to the States have led to great variability regarding coverage for Social Security. One State may, for example, cover all of its teachers under a retirement system, and choose not to extend Social Security coverage to those positions. Another State may cover its teachers under a retirement system, but also provides its teachers an option to obtain additional, voluntary Social Security coverage through a referendum and subsequent modification to the State's Section 218 Agreement. A third State may provide retirement system and Social Security coverage to its teachers, but because of the divided-vote option, some individual teachers may fall outside of that coverage. Another State may provide neither voluntary Social Security nor retirement system coverage to its teachers, resulting in mandatory Social Security coverage even though the State's Section 218 Agreement does not establish that coverage. Likewise, these examples could all be present within a single State, depending on how the State defined its coverage groups.

Roles of Government Agencies and Non-Governmental Groups

Due to the complex nature of both Section 218 Agreements and the exceptions to coverage under section 210 of the Social Security Act, many groups are involved in determining employees' coverage status and, subsequently, in monitoring that FICA taxes are being paid correctly.

Employers are the first and most important group, as they are ultimately responsible for appropriately withholding their employees' taxes, including FICA taxes. Employers are also generally in the best position to differentiate between individual employees' coverage statuses because they deal with their employees at an individual, unaggregated level. Under section 210, most private employees are covered. For State and local employees, however, coverage can vary substantially between States, positions, retirement systems, and even individual employees. To determine whether FICA is applicable under section 218, the State or local employer must determine if an employee's position is covered under the State's Section 218 Agreement. If not, the employer must then determine whether the employee is mandatorily covered under section 210 by establishing whether the employee is a member of a public retirement system. Using this information, employers are responsible for determining whether an individual is covered for Social Security and if FICA taxes should be withheld.

State and local employers often receive additional help in making coverage determinations, due to the complexity inherent to Section 218 Agreements. SSA, through regulation, requires each State to have a State Social Security Administrator (State Administrator). The State Administrator is a State employee who is responsible for maintaining and administering provisions of the State's Section 218 Agreement. The administrator is responsible for determining which State and political subdivision employees are covered by approved Section 218 Agreements and modifications, facilitating the expansion of coverage through additional modifications to the State's agreement, and providing SSA updates when there are changes in covered State or political subdivision entities. They also work with State and local employers to guarantee proper Social Security withholding and reporting, provide education to State and local employers and employees, and resolve coverage and taxation questions in coordination with SSA and IRS. The State Administrator also plays a central role in communicating information between SSA and State and local entities. Because Section 218 Agreements are voluntary agreements between SSA and the States, SSA's communications to State and local entities must flow through the State Administrator. State Administrators are an essential part of this process and we appreciate the service they provide and the hard work that they do.

SSA primarily provides support by confirming coverage status under a State's Section 218 Agreement. At the State Administrator's request, we explain entities' coverage options, review proposed modifications to the State's Section 218 Agreement for legal sufficiency, and evaluate the coverage status of entities and positions when questions arise. We interpret, execute, and maintain Section 218 Agreements, as specified under section 218 of the Social Security Act and in coordination with State laws. We work closely with the State Administrators and their umbrella organization, the National Conference of State Social Security Administrators (NCSSSA), to identify coverage compliance risk factors, answer questions, and resolve any issues that arise. We also assist in educating the administrators on complex or error-prone aspects of coverage and provide them with the information necessary to understand and administer complex coverage situations under section 218. We also support State Administrators with outreach to State and local entities and by participating in educational sessions for referendum voters. Finally, we are also responsible for establishing and maintaining our earnings records based on the amount of wages paid to employees.

Prior to 1987, SSA was responsible for collecting Social Security and Medicare contributions from the States and ensuring that each State paid the correct amount of FICA taxes for all employees covered under its Section 218 Agreement. The State Administrators were responsible for ensuring that State and local government employers filed timely and accurate returns and that they collected and paid the proper amount of Social Security and Medicare contributions to the Federal government.

Effective January 1, 1987, the Omnibus Budget Reconciliation Act of 1986 transferred responsibility for collecting employment taxes for wages paid under Section 218 Agreements from SSA and the States to the IRS. State and local employers are now required to file Form 941, the Employer's Quarterly Federal Tax Return, with the IRS directly, and the IRS is responsible for collecting Social Security and Medicare taxes. In addition to collecting taxes, the IRS verifies the amount of taxes owed and determines the amount that has been paid. It is also responsible for

interpreting FICA-related provisions of law and ensuring proper reporting and collection of taxes.

Finally, in addition to the important roles that employers, State Administrators, SSA, and the IRS play, employees are offered the opportunity to regularly review the taxes that are being withheld via their pay stubs and tax documentation. To assist with this and to allow individuals to review the benefits their covered earnings should provide them, individuals may access their earnings records through the *Social Security Statement*, which is available to them at any time through a [my Social Security](#) account.

Earnings Corrections

The Social Security Act directs us to presume that our earnings records are correct as posted. Employers are responsible for classifying wages as covered or non-covered and reporting earnings appropriately. That said, there are instances in which we need to correct an individual's posted earnings.

We frequently learn of small-scale errors through what is known as the "reconciliation" process. Every year, the IRS and SSA compare the wage information that employers report to the IRS on form 941 with the earnings report information that SSA obtains from processing forms W-2 and W-3. If the employer's aggregate Social Security and Medicare wage amounts do not correspond to the W-2 and W-3 totals, then either IRS or SSA investigates and resolves the discrepancy, depending on the nature of the discrepancy. However, the reconciliation process will not catch situations where employers have misidentified their employees' earnings as covered or not covered.

We may find errors when individuals apply for Social Security benefits. In the course of reviewing an individual's application, we investigate inconsistencies, such as gaps, which may indicate an error in employer-reported earnings information. If an applicant informs us that his or her earnings record is incorrect, we request primary evidence of his or her earnings (e.g., a Form W-2 or W-2c, an employer-prepared wage statement, a statement of an employer, or a pay stub) or two pieces of secondary evidence to corroborate his or her claim. If our review of the evidence leads us to determine that our posted earnings are incorrect, we correct the Social Security wages in our system. The earnings correction determination is then sent to the IRS to alert it to the possibility of uncollected taxes.

We note that Social Security insured status and benefit payment depend upon the amount of an individual's covered earnings and not on the FICA taxes that he or she has paid. The Act bases covered earnings on an individual's wages, and not on the amount of FICA paid for that individual. If we detect an error in the earnings record, locate evidence justifying that a correction is warranted, and then correct the error, we will immediately extend insured status or will base the amount of an individual's benefit on the corrected amount.¹

¹ The Trust Funds are also credited based on the amount of earnings, rather than on the taxes paid. Prior to 1950, the IRS accounted for all Social Security tax receipts (including penalties, interest and additional taxes), and upon receipt immediately credited such money to the Social Security Trust Fund. This method presented two difficulties

Additionally, if a State or local employer realizes that it should have been withholding FICA for its employees and had not been, we will credit the earnings based on sufficient evidence of the wages paid to the employees. IRS is responsible for collecting all taxes (including FICA) to the extent permitted by law. Because under the Social Security Act an individual's Social Security insured status and benefit amount depend on wages paid to the individual, we credit the individual's earnings record regardless of whether FICA has been paid.

While instances do arise where FICA taxes were not paid, earnings mistakes and corrections go both ways. Many errors we see involve situations where an entity pays FICA in the mistaken belief that its employees are covered. When a State or local entity has paid Social Security taxes without an appropriate modification to the State's Section 218 Agreement, we work with the State to allow affected individuals to legitimize coverage based on the erroneous FICA contributions. However, the State has the option to either amend its Section 218 Agreement through an error modification, or to forego coverage and receive a refund of erroneous FICA payments. When the State decides to legitimize the coverage, no earnings correction is necessary, and no employee is harmed by an inability to recover FICA payments under IRS' three-year statute of limitation on refunds.

Recent Improvements to the Administration of Section 218 and Our Partnerships

To strengthen our efforts in this area, we took several actions in response to the Government Accountability Office's 2010 audit, "Social Security Administration: Management Oversight Needed to Ensure Accurate Treatment of State and Local Government Employees."

Increased Communication with NCSSSA and IRS

Since then, we have strengthened our relationship with the NCSSSA and the IRS through the creation of the Section 218 Council, which is a collaboration established to increase communication between the Federal agencies and the State Administrators. We regularly meet and have informal conversations to discuss coverage risk factors, work collaboratively when issues arise, and offer ongoing training in areas that SSA and IRS have determined may require extra attention. We also participate in quarterly Section 218 Council meetings, meet annually with NCSSSA leadership, and provide substantive training for State Administrators at NCSSSA's annual conference. During the 2016 NCSSSA conference, which was open to all State Administrators, we presented at length on a variety of topics, such as completing Section 218 Agreement error modifications after mandatory coverage; mandatory and voluntary

for SSA: first, while cash flow out of the Trust Fund occurred at periodic intervals on a predictable basis, cash flow into the Fund fluctuated considerably and irregularly; and second, SSA received no money for employers who had forwarded individual wage data, but then did not pay their taxes.

Congress changed the law to alleviate these problems in the Social Security Act Amendments of 1950. This law provided that Social Security taxes to be transferred to the Trust Funds would be computed by applying the appropriate tax rate to the wage and self-employment records established and maintained by the Secretary of Health and Human Services (formerly Health Education and Welfare), as certified to the Secretary of the Treasury. This, in effect, meant that SSA's Trust Funds would be credited upon the basis of employer tax liability, not necessarily payment.

coverage and their exclusions; how to fix Section 218 Agreement errors; coverage considerations for rehired annuitants; and how State and local entities can evolve. In recent years, SSA has also provided training on critical and developing issues, including the treatment of charter schools and coverage for police and firefighters who are under retirement systems.

Developed Comprehensive Training Materials, Guidance, and Resources

We created comprehensive material for our website, the State and Local Coverage Handbook, and a dedicated training website designed for use by the State Administrators. In the past several years, we have diligently updated and expanded our online training materials to better equip State Administrators with the information, tools, contacts, and resources that they require to perform their jobs optimally. We provide the State and Local Coverage Handbook for the State Administrators' use, which is SSA's unredacted policy on the subject matter. The section 218 training website entails basic and advanced training courses that provide more detailed guidance on how to administer section 218. In addition, we developed an internal tool where we consolidate policy, procedures, and resources by topic so SSA employees have easy access to information relating to section 218 and how it is administered in one spot.

Established Regional Experts

In addition to creating these valuable training resources, we have stepped up our efforts to assist State Administrators with their frequent requests for guidance and evaluations on whether specific groups of employers are covered by their State's agreement. Each SSA region has a specialist who is the point-of-contact for all questions from State Administrators in that region. The regional specialist works to quickly resolve any questions that State Administrators may have. At a State Administrator's request, we will also assist with communicating information to State and local entities, through educational sessions and informational meetings.

Helped to Develop IRS' Compliance Self-Assessment Tool

To offer an additional tool to the States, we assisted the IRS, in collaboration with NCSSEA, with the creation of the Federal, State, and Local Government Compliance Self-Assessment tool (IRS Form 14581). We promote this tool on our external section 218 website, as a way to allow employers to test their coverage compliance and to identify areas where there may be issues or that may require their increased attention. It also explains several common types of errors and offers resources for States' use.

Created a Section 218 Agreement Database

We are also streamlining our coverage review process by allowing greater internal access to relevant documents. We have created a database of Section 218 Agreements, modifications, and related documents, which will allow us to complete a portion of the research needed for State-requested coverage determinations with greater ease. Once fully functional, this database will allow our employees to search for entities among a State's Section 218 Agreements and modifications, saving our legal team valuable research time.

Reviewing State and Local Regulations, Standardizing Lists of Covered Entities

SSA's role within the coverage and tax withholding compliance process is limited. Our primary function is to assist State Administrators in executing coverage modifications that effectuate the State's coverage scheme; to interpret and confirm the coverage provisions contained in State Section 218 Agreements; and to serve as a partner and educator to the IRS and the States. But we are redoubling our efforts to complete our role more effectively and to assist our government partners. To that end, we are currently reviewing our regulations and guidance related to State and local government coverage. We are looking for ways to streamline, clarify, or eliminate such guidance, while keeping our underlying policy and business processes intact. These changes should provide better clarity for our employees as they evaluate and execute Section 218 Agreements. We are also looking to standardize the maintenance of comprehensive lists of covered entities for each State. These lists provide a quick reference of covered entities under each State's agreement and help SSA and State Administrators determine employees' coverage efficiently. We are looking at ways we could enhance our maintenance of these lists across all regions with greater uniformity.

Through our educational presentations, online tools, and recurring conversations, we strive to provide the State Administrators with the information they need to ensure proper implementation of coverage. Through conference participation, annual meetings with NCSSSA leadership, and ongoing conversations with IRS and NCSSSA, we have developed relationships that enable State Administrators to facilitate better and more frequent communication with us when issues arise and to help prevent coverage errors from occurring.

Conclusion

Thank you for the opportunity to describe the history and complexity of Social Security coverage under section 210 and section 218 of the Social Security Act, as well as SSA's role in the coverage and tax withholding compliance process. Our relationship with the State Administrators and with the IRS is a vital one and we are committed to continuing to do our part to strengthen it.

Chairman Johnson. Thank you, ma'am.

Ms. Lough, welcome. Please, proceed.

**STATEMENT OF SUNITA LOUGH, COMMISSIONER, TAX EXEMPT
AND GOVERNMENT ENTITIES DIVISION**

Ms. Lough. Chairman Johnson, Chairman Buchanan, Ranking Member Larson, Ranking Member Lewis, and members of the subcommittees, thank you for the opportunity to testify on issues surrounding the proper withholding and payment of Social Security and Medicare taxes in regard to State and local government employees.

Mandatory Social Security and Medicare coverage for State and local employees is a relatively recent development. Under the original Social Security Act of 1935, State and local government employees were excluded from Social Security coverage. Beginning in 1951, States were allowed to enter into voluntary agreements with the Federal Government to provide Social Security coverage to public employees. These arrangements are called Section 218 agreements because they are authorized by the Section 218 of the Social Security Act.

In 1991, Congress made Social Security coverage mandatory for State and local government employees who were not already covered by a Section 218 agreement. But this mandate does not apply to employees participating in a qualifying public retirement system sponsored by their government employer. So today Social Security coverage of Government employees varies greatly among State and local employers.

In general, employers are required to withhold Social Security and Medicare taxes from employees' wages and also pay the employer's share of these taxes. Employers are responsible for furnishing Form W-2 Wage and Tax Statement annually to each employee when income, Social Security, or Medicare tax was withheld. Employers above a certain size report quarterly to the IRS on total wages, wages subject to Social Security and Medicare taxes, and Federal income taxes using the Form 941, Employer's Quarterly Federal Tax Return. Smaller employers file annually using Form 994, Employer's Annual Federal Tax Return.

For State and local employers, determining proper withholding of FICA taxes for employees is especially challenging because some or all employees may or

may not be covered by Social Security. For example, a school district may provide a qualifying retirement system only for a particular group of employees who meet certain criteria, not just teachers, making that group of employees exempt from Social Security coverage.

The IRS has the responsibility for ensuring that all employers, both public and private, properly withhold and pay Social Security and Medicare taxes for their employees. The IRS and the SSA routinely match Social Security and Medicare wages on Form 941 with amounts reported on Form W-3, the Transmittal of Wage and Tax Statements, and follow up where there are discrepancies.

In addition, the IRS reviews employment tax return information to classify returns for potential discrepancies that would indicate compliance action should be taken, including an audit. The IRS, through our Federal, State, and local function, has provided extensive outreach services and training to units of State and local governments. As indicated above, we conduct audits to evaluate employment tax and information reporting compliance at the State and local level.

The IRS also works with the SSA and State Social Security administrators on an ongoing basis on significant issues related to Social Security and Medicare coverage of public employees. This includes coordinating, when necessary, with the SSA or State Administrators when there is an audit of a public employer.

We look forward to continuing collaboration with State and local government employers, the SSA, and the State Social Security Administrator, to ensure that Social Security earnings are accurately reported for public employers.

This concludes my statement. I would be happy to answer your questions.

**WRITTEN TESTIMONY OF
SUNITA B. LOUGH
COMMISSIONER
TAX-EXEMPT/GOVERNMENT ENTITIES DIVISION
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON SOCIAL SECURITY
AND SUBCOMMITTEE ON OVERSIGHT
ON COMPLEXITIES AND CHALLENGES OF SOCIAL SECURITY COVERAGE
AND PAYROLL COMPLIANCE FOR STATE AND LOCAL GOVERNMENTS
JUNE 29, 2017**

INTRODUCTION AND BACKGROUND

Chairman Johnson, Chairman Buchanan, Ranking Member Larson, Ranking Member Lewis and Members of the Subcommittees, thank you for the opportunity to testify on issues surrounding the proper withholding and payment of Social Security and Medicare taxes in regard to state and local government employees.

Mandatory Social Security and Medicare coverage for state and local employees is a relatively recent development. Under the original Social Security Act of 1935, state and local government employees were excluded from Social Security coverage because of unresolved Constitutional questions regarding the federal government's authority to impose taxes on state and local governments and their employees.

Beginning in 1951, states were allowed to enter into voluntary agreements with the federal government to provide Social Security coverage to public employees. These arrangements are called "Section 218 Agreements," because they are authorized by Section 218 of the Social Security Act. All 50 states, along with Puerto Rico, the Virgin Islands, and approximately 60 interstate instrumentalities have Section 218 Agreements with the Social Security Administration (SSA), providing varying degrees of coverage for employees in the state.

In 1986, Social Security and Medicare coverage for state and local government employees became subject to different rules. Prior to 1986, the only way for public employees to be covered for Medicare was under Section 218 Agreements. In 1986, Congress mandated that almost all public employees hired after March 31, 1986, must be covered for Medicare and pay Medicare tax regardless of their membership in a public retirement system. A limited exception is provided to exempt from Medicare certain state and local government employees who have been in continuous employment with the same public employer since 1986 and who are not covered under a Section 218 Agreement.

Originally, the SSA collected Section 218 taxes from governmental employers, but that responsibility was transferred to the IRS in 1987. However, the SSA retains the responsibility for assisting public employers as they follow applicable federal laws regarding Social Security and Medicare coverage, and for helping them ensure earnings records for workers paying into Social Security and Medicare are accurate.

In 1991, Congress made Social Security coverage mandatory for state and local government employees who were not already covered by a Section 218 Agreement. But this mandate does not apply to employees participating in a qualifying public retirement system sponsored by their governmental employer. Approximately one-fourth of the nation's public employees are exempt from Social Security because they are covered by a qualifying public retirement system.

Today, Social Security coverage of government employees varies greatly from state to state. In 26 states, at least 90 percent of state and local government employees work in positions covered by Social Security. By contrast, in California, Colorado, Louisiana, Nevada, and Texas, fewer than half of state and local government employees are covered.

Coverage also varies greatly among the 90,000 local government entities in the U.S. There are an estimated 12 million full-time equivalent employees at the local level with payrolls in excess of \$50 billion. These local entities, which range in size from major cities to tiny villages and school districts, employ approximately 20 percent of the U.S. workforce.

In fact, the largest proportion of government employees not covered by Social Security work at the local level. The majority of uncovered local government public employees are police officers, firefighters and teachers.

Within this context, the interaction of federal tax, Social Security and state statutes and Section 218 Agreements creates complexities for governmental employers trying to determine correct Social Security coverage for their employees. Educating employers and enforcing compliance requires the coordination of the SSA and the IRS, as well as Social Security administrators employed by each state, who act as a bridge between the federal agencies and state and local employers.

PUBLIC EMPLOYERS' RESPONSIBILITIES UNDER FICA

Generally, the funding mechanism for the Social Security and Medicare programs is established under the Internal Revenue Code as the Federal Insurance Contributions Act (FICA). In general, employers are required to

withhold Social Security and Medicare taxes from employees' wages, and also pay the employer share of these taxes.

Employers are responsible for furnishing Form W-2, *Wage and Tax Statement*, annually to each employee from whom income, Social Security and/or Medicare tax was withheld. Employers above a certain size report quarterly to the IRS on total wages, wages subject to Social Security and Medicare tax, and federal income tax, using Form 941, *Employer's Quarterly Federal Tax Return*. Smaller employers file annually using Form 944, *Employer's Annual Federal Tax Return*.

For state and local employers, determining proper withholding of FICA taxes for employees is especially challenging, because employees may or may not be covered by Social Security. As noted above, Social Security coverage does not apply to employees who are members of a qualifying public retirement system – which is also referred to as a “FICA replacement plan” – unless those employees are covered under a Section 218 Agreement. Employers with workers in a qualifying public retirement system and not covered by a 218 Agreement do not withhold Social Security taxes or show any “Social Security wages” on the W-2 form for those employees.

Making this situation still more challenging, variations often exist in Social Security coverage among employees working for the same public employer. For example, a school district may provide a qualifying public retirement system only for a particular group of employees who meet certain criteria, such as teachers, making that group of employees exempt from Social Security coverage. Other workers, such as school bus drivers, who are employed by the same school district but not covered by that retirement system, would be covered by Social Security and thus subject to FICA withholding. Some employees may be covered by both the public retirement system and a Section 218 Agreement.

An additional consideration for local employers involves determining whether their public retirement system does in fact qualify as a FICA replacement plan and thus allows their employees to be exempt from Social Security coverage. Making this determination has become more of a challenge in recent years because of the dramatic changes in retirement-plan design that have occurred since mandatory Social Security coverage was implemented in 1991. Confusion among public employers arises in part because employees must be covered for each payroll period, potentially creating a constant in-and-out-of-coverage situation with each pay period (depending on the plan design), for what the IRS defines as FICA equivalency. This can create situations where entities may have been paying Social Security in error, or not paying Social Security when they should have been.

IRS COMPLIANCE EFFORTS IN THE STATE AND LOCAL AREA

Ensuring Employment Tax Compliance among Public Employers

The IRS has the responsibility for ensuring that all employers, both public and private, properly withhold and pay Social Security and Medicare taxes for their employees.

In attempting to determine proper withholding and payment of employment taxes, the IRS and the SSA routinely match Social Security and Medicare wages on Form 941 with amounts reported on Form W-3, *Transmittal of Wage and Tax Statements*.

When more wages are reported on Form 941 than on W-3, the SSA investigates, and the employer ultimately may be subject to penalties for inaccuracies under the tax law. When more wages are reported on Form W-3 than Form 941, the IRS will investigate whether the employer underpaid employment tax, and can assess any additional tax that may be due. Typically, the first action the IRS will take when a discrepancy is found is to send the employer a reconciliation notice, giving them a chance to explain or correct the discrepancy.

After compiling all the information from submitted employment tax returns, the IRS gathers employment tax data on government entities through its Return Information and Classification System (RICS) to classify returns for further attention. If the IRS determines that a potential discrepancy exists, it may take compliance action. This may involve an audit.

Looking at the overall picture of a public employer's reported withholding and payment amounts does not always allow the IRS to uncover errors, because applicable exceptions apply at the employee level, not at the entity level. Coverage exceptions are based on the circumstances of each employee, such as job position and date of hiring.

The IRS can glean some information from the W-2, because employers must report on line 13 if the employee is an active participant in a plan for federal, state or local employees. However, employees participating in such a plan may still be covered under a Section 218 Agreement. Generally, these line items indicate valid reasons why FICA may not apply, but not the precise amount of any exception, which may vary employee by employee. Moreover, a state or local employer – like all employers, public or private – may take a filing position under the tax law that certain payments to employees are excludable from wages, and thus not subject to FICA or reported to the IRS.

The IRS's Federal, State and Local Function

The IRS created the Federal, State and Local (FSL) function within the Tax Exempt/Government Entities (TE/GE) division in 2000 to serve as the focal point within the IRS for meeting its compliance responsibilities in the state and local

government area. Since then, FSL has provided extensive outreach services and training to units of state and local governments.

For example, the FSL section on IRS.gov provides a wealth of information to state and local employers, including the Public Employers Toolkit. The Toolkit includes links to various employment tax forms, along with IRS publications available to public employers to help them understand and comply with employment tax requirements.

FSL has also focused on conducting audits to evaluate employment tax and information reporting compliance at the state and local levels. However, the number of these audits is relatively small. FSL completed 372 audits of public employers in Fiscal Year (FY) 2015 and 362 audits in FY 2016.

As part of its efforts, FSL several years ago conducted reviews of state-level Section 218 Agreements in order to develop a more complete picture of these agreements and structures that define Social Security coverage of public employees in each state. The information gained from this assessment is helping improve FSL's overall service and compliance efforts at the state and local levels.

FSL also works with the SSA and state-employed Social Security administrators on an ongoing basis on significant issues related to Social Security and Medicare coverage of public employees. This includes coordinating, when necessary, with the SSA or state administrators when there is an audit of a public employer. For example, during an audit of a local government, the IRS may contact the Social Security administrator for that locality's state to clarify the employer's status. This includes determining whether the entity's employees are covered under a Section 218 Agreement and, if so, what specific exclusions apply to that entity that must be taken into account during the audit, including exceptions that are unique to certain employees.

The IRS also regularly receives helpful guidance and support from its Advisory Committee on Tax-Exempt/ Government Entities (ACT) on employment tax issues related to state and local governments. For example, in its 2017 annual report, the ACT noted the confusion that exists among various local governments, especially smaller entities, regarding whether their retirement systems can be considered FICA replacement plans. The ACT recommended that the IRS provide additional training and support, both to FSL examiners and local governments, on the complexities of retirement plan design. Additionally, the ACT recommended that auditors of state and local entities include Section 218 coverage and FICA replacement plan requirements within the auditing scope for their financial statements.

FSL will continue working to improve outreach, education and compliance activities related to state and local government employers. FSL also looks

forward to continuing collaboration with the SSA and state Social Security administrators, to ensure that Social Security earnings are accurately reported for public employees.

Chairman Johnson, Chairman Buchanan, Ranking Member Larson, Ranking Member Lewis and Members of the Subcommittees, this concludes my statement. I would be happy to answer your questions.

Chairman Johnson. Thank you, ma'am.

Ms. Motza, is that correct pronunciation?

Ms. Motza. It is Motza, but that is close enough.

Chairman Johnson. Thank you. You are recognized. Please, proceed.

**STATEMENT OF MARYANN MOTZA, PH.D., LEGISLATIVE
COMMITTEE CHAIR AND PAST PRESIDENT, NATIONAL
CONFERENCE OF STATE SOCIAL SECURITY ADMINISTRATORS**

Ms. Motza. Thank you.

Chairman Johnson, Chairman Buchanan, Ranking Member Larson, Ranking Member Lewis, and members of both subcommittees, thank you for inviting the National Conference of State Social Security Administrators, or NCSSSA, to testify about the States' perspectives on Social Security coverage and payroll tax compliance by State and local government.

To supplement our written testimony, I want to provide Members of Congress with a couple of examples of the types of issues and concerns the State Social Security administrators deal with.

A small town calls the State Administrator in utter panic. The IRS' service center in Cincinnati is about to seize all of the town's police and fire vehicles for failure to pay FICA on their police officers and firefighters. The service center assumes Social Security payments were owed based on its review of 941 filings.

The State Administrator's record show that a town has a Section 218 agreement that covers civilian employees under Social Security, but excluded police officers and firefighters. The State Administrator intervenes and provides the accurate coverage and tax obligation information to the IRS, and they reverse their erroneous assessment. The town can continue protecting and serving the public.

Another example is that in the early 1950s a State provides public pension plan coverage for their employees, but not for employees of its cities and towns. State legislature authorizes voluntary Social Security coverage for employees of cities and towns. The city of last resort enters into a Section 218

agreement in 1954. In 1961, the State legislature establishes a separate public pension plan for employees of cities and towns.

The next year, the city asked the State Administrator to file the necessary paperwork with the Social Security Administration to withdraw from the Section 218 agreement so they can join the new public pension plan. SSA approves the withdrawal from Social Security in 1965. If the city had waited to request permission to withdraw until the mid-1980s, the State Administrator would not have even contacted SSA and instead would have advised the city that withdrawal from Social Security was no longer an option.

These two examples show how the State Administrator is the critical bridge or liaison and facilitator between the Federal Government, both SSA and IRS, and States, public employers, employees, and pension systems. Rather than being a one-way street and just sending information from the Federal Government down to the State and local governments, the Social Security State Administrator is the key conduit of information both ways.

The proper performance of that facilitator role, however, has been problematic since 1987, in part because of how the Treasury Department and IRS interpreted an IRC Section 6103. The State Administrators are no longer aware of noncompliant public employers. The lack of communication between the IRS and State Administrators results in erroneous Social Security and Medicare coverage and benefits, as well as incorrect FICA tax assessments by the IRS.

Since 2012, the IRS has identified approximately 10 major risk areas nationwide among State and local governments. The IRS cannot, however, tell State Administrators what specific issues exist in their individual States. Thus, the State Administrator cannot assist the public employers to voluntarily comply like they did prior to 1987.

The valued partnership with SSA also needs to be renewed and reinvigorated. Prior to 1987, the States and SSA worked closely together to ensure proper coverage and collection of contributions. Since 1987, the efficiency and effectiveness of that partnership has been erratic and has even at times resulted in inconsistent advice from different regional offices and the headquarters policy office.

A further complicating factor is that the Government Accounting Standards Board, GASB, disclosure standards and other auditing oversight organizational guidance standards do not test for Social Security or Medicare. As a result, when public employers receive a so-called clean audit, they have no idea that a

potentially significant noncompliance area isn't even being examined. A FICA standard will account for 71 percent of State and local government employees' earnings nationwide that are currently not even reported on financial statements.

In conclusion, the irony of the State Administrator job is that when our role is performed properly and completely, it gives the impression that either nothing is being done or the job is minimal. To me, the job of State Social Security administrator is like a duck on a pond, everything looks smooth and unlabored on the surface, but underneath you are padding like crazy. NCSSSA would appreciate congressional, SSA, Treasury Department, and IRS help with the paddling.

I am happy to answer questions. Thank you.

Statement by Dr. Maryann Motza
Legislative Committee Chair and Past President of the
National Conference of State Social Security Administrators (NCSSSA)
on
Complexities and Challenges of Social Security Coverage and
Payroll Tax Compliance for State and Local Governments
before
Committee on Ways and Means,
Subcommittees on Social Security and Oversight
U.S. House of Representatives
June 29, 2017

Introduction

Chairman Johnson, Ranking Member Larson, Chairman Buchanan, Ranking Member Lewis, and Members of both Subcommittees: thank you for inviting the National Conference of State Social Security Administrators (NCSSSA) to testify about the states' perspectives on Social Security coverage and payroll tax compliance for state and local governments.

I am Dr. Maryann Motza and I served as the State Social Security Administrator for the State of Colorado from April 1993 through December 2016. I am proud to say I was elected to serve as NCSSSA President on three separate occasions and currently continue to serve as the NCSSSA Legislative Chair. I am honored to be selected by NCSSSA to testify on their behalf about roles of the states related to state and local governments' Social Security and Medicare coverage, FICA taxes, and public pension system compliance matters (collectively referred to in the remainder of this document as "state and local coverage" unless otherwise stated).

NCSSSA is available to assist members of Congress, and our federal partners in the Executive Branch (i.e., U.S. Social Security Administration "SSA", the Treasury Department, and Internal Revenue Service "IRS"), when any legislative or regulatory proposals or other issues arise associated with state and local government Social Security/Medicare coverage and FICA) taxes, and matters related to public pension systems to the extent they impact state and local coverage.

To provide the members of Congress with the proper context for our testimony we will start with a brief background on NCSSSA, followed by a high-level overview of key dates, specifically when changes to Federal laws affected state and local government Social Security and Medicare coverage. We will then address the role of the State Social Security Administrator (State Administrator) in administering Section 218 Agreements and ensuring FICA and employment tax compliance by public employers, challenges the State Administrators face, and areas for improvement. Finally, we will provide some cautionary comments about possible unintended consequences if certain actions are taken by Congress.

Background on NCSSSA

NCSSSA was founded in 1952, after the U.S. Social Security Act was amended by Congress to include Section 218 (codified as 42 U.S.C. 418) in 1950. NCSSSA is the only professional organization for State Administrators in the country. The NCSSSA was established to provide a unified state perspective at the federal level, an on-going medium for problem solving, and an open forum for the development of new policy with the federal government. Since its inception, the NCSSSA has provided an effective network of communication for federal, state, and local governments concerning Social Security (and Medicare) coverage, federal employment tax compliance, and public pension system policies.¹

History of State and Local Social Security and Medicare Coverage

A brief history of some of the most significant federal law changes that apply to state and local coverage is important to understand the remainder of our testimony.

¹ For further details on NCSSSA, State Social Security Administrators, and the unique legal requirements that apply to public employers and employees associated with Social Security and Medicare coverage and benefits, public pension plan requirements, and employment taxes, go to: <http://www.ncsssa.org/> and the *Federal-State Reference Guide* (IRS Pub. 963), which is a joint publication of the IRS, SSA, and NCSSSA: <http://www.irs.gov/pub/irs-pdf/p963.pdf>. See, also, M. Motza and D. Conder. "Common Errors in State and Local Government FICA and Public Retirement System Compliance", *Government Finance Review*, August 2009.

- **1935:** Social Security was first created. State and local government employees are not eligible to participate due to the Constitutional limitations regarding the power of the federal government to tax sovereign entities, i.e., the states. (Amendment X, U.S. Constitution)
- **1950-1951:** Many government employers did not, at the time, have their own retirement systems so the U.S. Congress amended the Social Security Act by adding Section 218 to allow states to voluntarily enter into agreements with the Social Security Administration to extend Social Security coverage to state and local government employees in their respective states who were not covered by a public retirement system. That approach ensured compliance with the state sovereignty requirement of Amendment X of the U.S. Constitution. Both “mandatory” and “optional” exclusions apply to Section 218 coverage agreements.

Voluntary Social Security coverage became available for state and local government employees for those **not** in a public retirement plan position (these types of Section 218 coverage groups are referred to as “Absolute Coverage Groups”). Modifications to these “master” Section 218 Agreement are used to add or change coverage for the state and its political subdivisions. Dissolutions are filed by the State Administrator to notify SSA that a public employer no longer legally exists.

Under federal law each state’s Governor was charged with implementing the voluntary coverage agreements on behalf of their state and its political subdivisions. State enabling legislation delineated how each state wanted to apply the U.S. Social Security Act (within federal guidelines). The State Administrators collect the Social Security contributions.

- **1954** -- Voluntary Social Security coverage became possible for those in a public retirement plan via a referendum process. The State Administrator must conduct the referendum elections and submit proper paperwork to SSA for final approval of Modifications to the state’s master Section 218 Agreement to effectuate such coverage.
- **1965** – Medicare program created and added to coverage for positions under a Section 218 Agreement.
- **April 20, 1983** – Section 218 Agreements became irrevocable going forward. State & local governments can no longer terminate all or part of their Section 218 Agreements with the SSA.
- **April 1, 1986** -- Mandatory Medicare applies to all new-hires by all state and local governments who are covered by a public retirement plan. Employees hired prior to this date and who have been in continuous employment with the same employer are exempt from Medicare coverage.
- **January 1, 1987** -- IRS became the direct collection agent for FICA taxes with enforcement authority. State Administrators no longer perform that function and SSA is no longer responsible for overseeing the Social Security/ Medicare collections by state and local governments.
- **July 2, 1991** -- The effective date for changes in federal law that were made in the Omnibus Budget Reconciliation Act of 1990, commonly referred to as “Mandatory Social Security.” Social Security coverage became required for most state and local government employees who are **not** already covered by a Section 218 Agreement or members of a FICA replacement public pension plan (“**Qualifying Plan**”) which is different from a **qualified** public pension plan.

Section 218 defines the states as **excluding** the District of Columbia, Guam, and American Samoa, therefore, for Section 218 purposes, NCSSSA refers to the states as 52 in total — all 50 states plus Puerto Rico and the Virgin Islands, collectively representing the more than 90,000 state and local government (public) employers and their more than 16.2 million employees.² Section 218 allowed states the option of **voluntarily** providing Social Security (and, since April 1986, Medicare-only) coverage for state and local government employees. Direct involvement of each state in determining the extent of Social Security (and later Medicare-only) coverage it wanted to provide to their state and local governmental employees ensured compliance with the state sovereignty requirement of Amendment X of the U.S. Constitution. Section 218 represents a mutual federal/state commitment to assure that voluntary participation in the Social Security program is a viable part of

² U.S. Department of Commerce, Economics and Statistics Administration, Census Bureau, “2012 Census of Governments: Employment Summary Report”, released March 6, 2014: https://www2.census.gov/govs/apes/2012_summary_report.pdf ; and “Government Organization Summary Report: 2012”, released September 13, 2013: https://www2.census.gov/govs/cog/g12_org.pdf ; and State and Local Government Payroll Data: 2012, released March 2012: State and Local Government Employment and Payroll Data: March 2012, 2012 Census of Governments: <https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmmk> .

employee benefit options available to state and political subdivision employees. The responsibility for administering the Section 218 Social Security program for public employees varies depending on each state's enabling legislation.

State Social Security Administrator Responsibilities and Value

NCSSSA wants to remind members of Congress of the long-standing responsibility each State Administrator must fulfill as the principal liaison between all of its state and local government employers, employees, and public pension systems and the federal government, especially the SSA and the IRS. Proper performance of that liaison function on a continuing basis helps avoid serious financial and public relations issues for the states and their political subdivisions as well as for the federal government.

The essence of each State Administrator's role and responsibilities in administering Section 218 and aiding in proper compliance with Section 210 (and Internal Revenue Code Section 3121) is to be a "bridge" between the federal government -- both the SSA and the IRS -- and the nation's public employers and employees and their legal and financial advisors. SSA Regulation 20 C.F.R. §404.1204 requires each state to designate at least one state official to administer that state's Section 218 Agreement.

The SSA is responsible for proper administration of Section 218 Agreements from the federal perspective. The SSA's Program Operations Manual System (POMS) includes a policy that outlines every state's duties applicable to proper administration of Section 218 Agreements.³ The detailed State Administrators' responsibilities are outlined in SSA's Program Operations Manual System (POMS) SL 10001.130, State Administrator Responsibilities (<https://secure.ssa.gov/apps10/poms.nsf/lnx/1910001130>). The major responsibilities of State Administrators that are listed in that policy are: 1. Administer Section 218 coverage; 2. Notify SSA about any state administrator changes; 3. Communicate with SSA, IRS, employers, and stakeholders; 4. Maintain Section 218 related records; 5. Perform education and outreach; 6. Determine necessary funding; 7. Determine necessary staffing; 8. Understand legal framework; and 9. Program strategies.

Legal opinions and interpretative documents such as those issued by each State Attorney General's Office, the SSA, or the Treasury Department/IRS are vital to proper interpretation of the agreements and their Modifications. The State Administrator's records are usually the sole repository of such interpretative documents, thus reinforcing the importance of State Administrators being actively involved in all Social Security and Medicare coverage and FICA tax enforcement actions involving state and local governments.

Thus, each State Administrator is the principal state official who ensures compliance with federal employment tax laws under Section 218 and related law and for verifying that state laws enacted in the future are not in conflict with federal requirements. Each Administrator also protects the interests of their individual state and its political subdivisions by properly analyzing current and proposed state laws coupled with the federal law, thereby ensuring the efficient and effective administration of Social Security and Medicare coverage, employment tax laws, and public pension system obligations for state and local government employers and employees. There are profound advantages to all levels of government nationwide in having a dedicated and knowledgeable State Administrator. Failure for states to continue funding these positions would be "penny wise and pound foolish"; the money "saved" by the states in defunding or otherwise reducing support for these positions will be more than offset when compliance problems are found by the IRS and/or SSA among state and local governments. The State of Missouri experienced first-hand the negative political consequences of ignoring the State Administrator function for many years.⁴ Their errors resulted in Congress requesting a special study by the U.S. Government Accountability Office (GAO). The GAO issued its final report in September 2010, which addressed: (1) how the Social Security Administration (SSA) works with states to approve Social Security coverage to ensure accurate coverage of public employees, and (2) how IRS identifies incorrect Social Security taxes for public employees.⁵

To address budgetary constraints and pension liability concerns, many state and local governments throughout the country have also been making changes to their pension systems and looking for ways to reduce their costs. These changes, however, without knowledgeable scrutiny, can have an adverse effect upon a state or

³ Social Security Administration Program Operations Manual System (POMS), SL 10001.130, State Social Security Administrator Responsibilities, <https://secure.ssa.gov/apps10/poms.nsf/lnx/1910001130>.

⁴ M. Grochowski, et al., REPORT: Federal Section 218 Task Force For Missouri School Districts, March 31, 2009, <http://oa.mo.gov/acct/033109FederalTaskForceReport.pdf>.

⁵ SOCIAL SECURITY ADMINISTRATION: Management Oversight Needed to Ensure Accurate Treatment of State and Local Government Employees GAO-10-938, Published: Sep. 29, 2010. Publicly Released: Oct. 4, 2010, <http://www.gao.gov/products/GAO-10-938>.

local government's federal tax compliance, as these state laws may conflict with federal law. As noted in the *Federal-State Reference Guide* (IRS Pub. 963; www.irs.gov/pub/irs-pdf/p963.pdf) and the above noted GAO study, this area of state and local government federal employment tax is intricate and seemingly minor changes can result in a federal tax liability.

Unlike their private sector counterparts, state and local governments not only face financial problems if they make errors in FICA tax compliance, they also have negative media and public relations consequences because they are supported by taxpayer funds. State Administrators are vital partners with the SSA and IRS in helping all levels of government avoid the negative financial, media, and political consequences that occur when federal and state laws are not properly complied with by state and local governments and public pension systems.

Thus, it is evident that the State Administrator has great responsibilities which impact the state's obligations under the Social Security Act, Internal Revenue Code, the Section 218 coverage Agreement, under state laws, and also on the Social Security and Medicare-only coverage of individual public employees. It is important that there continue to be a central point within each State where this expertise and experience is brought together for these purposes.

Challenges

The major challenges faced by the states in administering Section 218 and aiding in proper employment/payroll tax compliance by state and local government employers are:

1. **Since January 1987 when the IRS became responsible for collecting FICA taxes from state and local governments communication by the IRS with State Administrators about the nature and extent of Section 218 coverage has been virtually non-existent due to how the Treasury Department and IRS have interpreted I.R.C. §6103.** From the inception of Section 218 coverage in 1950-51 through 1986, State Administrators were responsible for collecting Social Security (and later Medicare) contributions from public employers and transmitting the funds to the U.S. Treasury Department. SSA exercised administrative oversight of the states for all aspects of Section 218, including ensuring both proper coverage and contribution payments.

NCSSSA thinks it is logical to assume that it was merely inadvertent oversight that the Treasury Regulations were not updated when the FICA tax obligations were transferred on January 1, 1987, from the states to the IRS. Thus, this change would be far less controversial than requests of others who have desired access to tax records from the IRS, especially since the states are one of the parties to each Section 218 Agreement and Modification (SSA is the other party). No individual local government or state agency or department can enter into a Section 218 Agreement without the state through that state's State Administrator.

The restriction on open communication with State Administrators due to the current interpretation of IRC §6103 places IRS Federal State and Local Government (FSLG) Specialists at a disadvantage and wastes IRS time and other resources. FSLG agents cannot discuss specific public employer tax information with the State Administrators even though that individual officially represents the state which is one of the parties to every agreement. Without this direct communication between the State Administrator and the IRS/FSLG, the IRS cannot correctly interpret coverage and, thereby, properly assess and resolve tax issues. This information is held solely by State Administrators who maintain their state's Section 218 Agreements and relevant supporting documentation, including critical interpretative rulings and determinations issued by SSA, the state's Attorney General's office, and IRS.

Since 1987, when the IRS assumed the tax collection responsibility, State Administrators no longer receive feedback on non-complaint public employers. The lack of communication between the IRS and State Administrators results in both erroneous Social Security and Medicare coverage and benefits as well as incorrect FICA tax assessments by the IRS. These errors have been documented in numerous places, including the study done by the Government Accountability Office (GAO).

Of particular note, that GAO report found that the lack of shared information among the SSA, IRS, and State Administrators is problematic to proper Social Security coverage and tax administration for this community. This constraint can readily be overcome by reinterpreting Treasury Regulations under 26

U.S.C. §6103(d) and 26 USC 3121 (FICA tax), which is explained further in the next section (Areas for Improvement).

2. **NCSSSA is seeing an unprecedented level of erosion of the states' political and financial support for the State Administrator function throughout the country.** As with other issues in this area, the beginning of this problem began in most states after their responsibility for collecting Social Security and Medicare contributions was removed as of 1987. Administration of Section 218 in many states relied on the "float" from interest earned from Social Security and Medicare contributions they received from employers of their covered employees. Those and other sources of funding for State Administrators, such as General Funds, have been diminished significantly especially since the economic downturn that occurred in 2007-2008. State Administrators need Congressional, SSA, and Treasury Department/IRS assistance to help reverse that trend. Details on our recommendations to address this challenge are noted, below, in the "Areas for Improvement", number 3.
3. **Proper administration of state and local coverage and tax compliance requires a robust succession planning and training program for all officials.** Since 1987 there has been a steady diminishment of planning and training in many states as well as within both the SSA and IRS. The SSA regional offices have been delegated responsibility for being the main resource for State Administrators, with SSA's headquarters having less of a role in Section 218 administration and oversight than was the case prior to 1987. Due to federal funding constraints, and high turnover in the individuals designated as contacts in this area, the SSA regional offices have less knowledgeable and experienced staff with state and local government policy and compliance. As a result, the regional offices sometimes provide inconsistent feedback to the states resulting in disparate treatment nationwide on similar issues.

Similar financial reductions at the IRS, especially in recent years, have been undermining the ability of the IRS's FSLG section to provide services to their state and local government customers. The problem is now further exacerbated by organizational changes the IRS implemented this year by placing FSLG under the Exempt Organizations office within the Tax Exempt and Government Entities Division. That change is likely to further dilute the ability of FSLG to focus on state and local governments' voluntary compliance with FICA and other employment taxes.⁶

4. **Need for improved communication among the states and our federal partners (both SSA and IRS).** One mechanism for accomplishing that goal already exists, the Section 218 Council. This is a collaborative group intended to bring out and hopefully address areas of mutual concern, but needs to be consistently used by all parties.

The Section 218 Council was an outgrowth of a special meeting in Baltimore that was convened in April 2010, by Mr. Ken Anderson, who was at the time, SSA's State and Local Government Policy Team Leader. The purpose of this meeting was to discuss issues, concerns, and develop recommendations for how to improve state and local government coverage and compliance. The meeting was called due to concerns that arose out of the Missouri Task Force Report and the Congressional request for the Government Accountability Office (GAO) to study Section 218 administration issues and concerns nationwide. The April 2010 meeting included officials from throughout the country who represented the SSA (headquarters Policy, Office of General Counsel, and Regional Offices), IRS (Federal, State, and Local Governments section), and states (Alabama, Arizona, Colorado, Idaho, Illinois, Kentucky, Louisiana, Maryland, Missouri, and New York). The meeting resulted in creation of several committees, each composed of SSA, IRS, and state officials, that were to follow-up on the April 2010 recommendations.

One of the key recommendations that came out of the April meeting was the need for the states to have a voice and direct involvement with SSA and IRS by increasing communication, provide a venue to raise and address issues and concerns, and facilitate feedback regarding ongoing efforts to address state concerns. The Section 218 Council Charter was finalized and the Council began meeting in September 2011. Implementation of, and support for, the Council has been inconsistent since it was created, appearing to be due to inadequate succession planning which, in turn, seems to be the result of funding constraints within the IRS and SSA. NCSSSA, however, has noticed improvement over the last few years; continuing the

⁶ This subject was included as a recommendation to IRS Commissioner Koskinen by the Tax Exempt and Government Entities (TE/GE) Advisory Committee's 2017 Report of Recommendations, issued June 7, 2017: <https://www.irs.gov/pub/irs-pdf/p4344.pdf> .

practice will greatly help both the federal and state governments assist state and local governments with Social Security and Medicare coverage and FICA/payroll tax compliance.

5. **Need a better understanding of, and appreciation by, the SSA and the IRS of the critical fact that no Section 218 Agreement or Modification can be entered into by local governments unless the state authorizes doing so. The state must be a party to each agreement and modification** and the State Administrator is the vital official who oversees and ensures proper processing of all such agreements. The State Administrator coordinates education of the state and local government employers and employees regarding their options under all relevant aspects of federal laws (both Social Security Act and Internal Revenue Code) and state laws is essential to ensuring public employers and employees make informed decisions about their financial futures. Unfortunately, in recent years, both SSA and the IRS have largely been unavailable in assisting the states in such education efforts.
6. **Need for greater understanding and appreciation of the importance of the State Administrator as the central repository of knowledge about both federal and state laws and critical interpretative documents applicable to each state's Section 218 Agreement/Modifications and public pension system coverage.** Neither the SSA nor the IRS have the insight into the nuances that exist in each state vis-à-vis their decision when each implemented Section 218 to the extent to which Social Security coverage was deemed appropriate for their public employees via their enabling statutes. The State Administrators also are familiar with the public pension systems and coverage that is unique to each state. Without including the State Administrator and the documentation held in his/her office, it is impossible for the IRS to properly oversee and enforce employment taxes for state and local governments, and for SSA to administer Section 218. That is where each State Administrator can be a vital partner in ensuring proper Social Security coverage and payroll tax compliance by state and local governments. That partnership and cooperation between the state and each federal agency is vital to ensuring the continued viability of Amendment X of the U.S. Constitution.
7. **Need for improvement in SSA and Treasury Department/IRS policy interpretations and issuance of regulations to be in consistent with the federal laws.** Issuance of new, and even amending existing, policies and regulations in this area without the unique insights the states can offer result in unnecessary complications to state and local coverage and FICA tax compliance, thereby making the program appear more complex than the law that governs it.

Areas for Improvement

NCSSSA has a number of recommendations that will improve state and local government coverage and compliance and proper administration of Section 218 and Section 210 of the U.S. Social Security Act and Internal Revenue Code Section 3121 and Section 6103 while ensuring adherence to state sovereignty guaranteed by Amendment X of the U.S. Constitution:

1. **Restore the strong working relationship between the states, SSA, and the IRS.** As noted above in the "Challenges" portion of this testimony, the relationship between the states and SSA was extremely strong and mutually respectful prior to the federal law changes that went into effect on January 1, 1987, when the IRS became responsible for collecting FICA taxes from state and local governments.⁷ From 1987 until the mid-1990's SSA was focusing on reconciling the pre-1987 Social Security and Medicare contributions by the states and the IRS was still learning about their new FICA tax customers and beginning implementation of the changes to federal law.

A positive turning point came in 1995 when the SSA, IRS, the State of Colorado, and Mercer cooperatively developed the *Federal-State Reference Guide* (IRS Pub. 963), which became the first-ever joint publication of the IRS, SSA, and a state. Publication 963 consolidated all of the key information needed by state and local governments about their unique Social Security and Medicare coverage and benefits as well as their public pension system and FICA tax obligations. It quickly became a key reference source not only for federal officials and State Administrators, but also for state and local government employers, employees, and their legal and financial advisors. To this day, NCSSSA (which assumed responsibility for fulfilling the

⁷ These issues were previously examined by the Office of Inspector General, U.S. Social Security Administration, in "Social Security Coverage of State and Local Government Employees", Audit Number A-04-95-06013, Issued December 13, 1996: <https://oig.ssa.gov/social-security-coverage-state-and-local-government-employees> .

role originally played by Colorado) is actively involved in providing input to the IRS and SSA on keeping the *Guide* current with federal law changes as well as recommending ways to improve it

Publication of the *Guide*, as well as joint training sessions for public employers and their legal and financial advisors were conducted by SSA, IRS, and state officials in many of the states which resulted in increased revenue to the Social Security and Medicare Trust Funds from state and local governments due to their voluntary compliance because they now had a better understanding of their legal obligations. As reported at the NCSSSA annual conference in Rapid City, South Dakota, in July 2002, the Director of the IRS's FLSG section reported a four-year estimate (1997 through 2000) of \$12 billion in both Social Security and Medicare Trust Fund payments attributable to the joint nationwide education and outreach effort that began when the *Guide* was first published. The funds were paid in without the expense of IRS examinations or compliance checks, but simply because the public employers were given an easily understandable description of what they were required to do for each of their employees. That is a perfect example of what the states, SSA, and the IRS can do when we work together cooperatively rather than in an adversarial manner.

Cooperation between the federal partners (both SSA and IRS) and State Administrators has consistently had the most profound impact on voluntary compliance by state and local governments' Social Security and Medicare coverage and FICA tax compliance. We encourage Congress to reinforce the vital role of the State Administrator as an integral partner in ensuring accurate Social Security and Medicare coverage and voluntary FICA tax compliance by state and local governments. This is discussed further in number 3, below.

2. **NCSSSA recommends that the U.S. Treasury Department adopt a reinterpretation to the Treasury Regulations associated with Internal Revenue Code §6103 (I).** That change would facilitate state and local governments' compliance with U.S. Code sections (both the U.S. Social Security Act and U.S. Internal Revenue Code). Naming State Administrators (State Administrators) as a group to be allowed to receive information from the U.S. Internal Revenue Service (IRS) will improve voluntary compliance by state and local government entities, reduce improper Social Security or Medicare coverage and taxation, and also reduce the tax gap.

NCSSSA recommends an amendment to the Treasury Regulation by adding a new provision to the regulations that interpret and apply Internal Revenue Code (IRC) §6103. Likewise, regulations pursuant to 26 USC 3121 (FICA tax) should make it clear that the State Administrator, and his/her designee, shall be considered a taxing authority. These changes will clarify the unique situation associated with state and local governments' FICA and public pension system requirements that exist under both federal and state laws due to the Amendment X of the U.S. Constitution and Section 218 of the U.S. Social Security Act. They will also permit the disclosure of tax information to State Administrators who are designated pursuant to 20 C.F.R. §404.1204.

State Administrators can help all levels of government avoid the negative financial, media, and political consequences that occur when federal and state laws are not properly complied with by state and local governments and public pension systems. Unlike their private sector counterparts, state and local governments not only face financial problems if they make errors in FICA tax compliance, they also have negative media and public relations consequences because they are supported by taxpayer funds. Allowing full and open discussion of all information associated with state and local governments' Social Security and Medicare coverage and public pension system coverage by the IRS and SSA will reduce IRS expenses. That, in turn, will save U.S. citizens money because all of the parties involved in state and local coverage are funded from various types of taxes.

3. **To address the diminishing state support for the State Administrator positions in many states nationwide, NCSSSA and our member states need Congressional, SSA, and the Treasury Department/IRS assistance to help reverse that trend.** It sounds self-serving and hollow for State Administrators to tell state officials how important the role is, but having the federal government reinforce that fact has historically had a profound impact on the states, albeit often short-lived. SSA and IRS communication with states is valuable, such as another joint letter from either or both SSA and the IRS to Governors and State Administrators that references the federal law and on-going responsibilities associated with administering the Section 218 Agreement. The letter should also stress the importance of maintaining and proactively managing the federally mandated Section 218 program. Similar letters sent in the past

letters have brought to the forefront the importance of the State Administrator position. NCSSSA provided to both SSA and IRS some past sample letters of support in May 2016 and prepared a recommended first draft of a letter in September 2016, however, the SSA is still working on vetting a final version. IRS notified us several months ago that they do not want to intervene because the main area of federal law that governs the State Administrator function falls under the jurisdiction of SSA, not the IRS

Congressional action, however, is best. Although letters from SSA and/or IRS are helpful, they do not have any long-range impact largely because of turnover and new political officials assuming various positions in the states. A formal Resolution from Congress, therefore, would be preferable or, at a minimum, a valuable adjunct to letters from SSA/IRS. Such a Resolution should strongly reinforce the critical importance of the State Administrator as the bridge between the federal government and each state/local government.

Congress should provide grants to the State Administrators, SSA, and IRS that are earmarked to provide on-going education and outreach to state and local governments, public pension plan officials, and their legal and financial advisors. As documented earlier in this testimony, education and outreach have consistently proven to be far less costly and have a longer-term effectiveness, especially with state and local governments, than enforcement efforts, such as examinations and compliance checks.

Further, all parties need to reinstate and reinforce the federal-state partnership which was so effective prior to 1987. A critical component of doing so is for Congress, SSA, and Treasury/IRS to reinforce the importance to all states of providing political and funding support of the State Administrator function. Doing so benefits all parties, but most importantly ensures state and local governments have a secure retirement, survivor, and disability insurance available to them so they do not need public assistance to survive.

Partial federal funding of the State Administrator positions, through grants, would be a means to ensure consistent and reliable state support for the federally mandated responsibility. To ensure such funding does not undermine adherence to the Tenth Amendment, however, such grants should be restricted to funding the State Administrator function with the understanding that the role and position remain free of federal influence vis-à-vis choosing to provide Social Security and/or public pension plan coverage for their state and local government employees.

4. **Support revision of, and clarifications to, Treasury Regulations associated with FICA public pension replacement plans.** The Omnibus Budget Reconciliation Act of 1990 (OBRA 1990) included requiring Social Security coverage for state and local government employees who are not already covered by Social Security under a voluntary Social Security coverage agreement (i.e., Section 218 Agreement) or a public pension plan that provides comparable benefits to those afforded by Social Security. Although there are other nuances, OBRA 1990 and the Treasury Department/IRS regulations implementing that law basically identified two major types of public pension plans that are considered to be “qualifying FICA replacement plans”: defined benefit plans (Revenue Procedure 91-40) and defined contribution plans [Treasury Regulation Section 31.3121(b)(7)-2(e)(2)(iii)(A)]. These qualifying plans allow for participating employees to be excluded from the required payment of FICA contributions under Section 210 of the Social Security Act, commonly referred to as Mandatory Social Security.

Since OBRA 1990 was enacted and the Treasury Department/IRS adopted regulations implementing the state and local government employees’ Social Security coverage provisions, administrators of public pension plans have created additional types of pension plans beyond defined benefit and defined contribution, such as hybrid plans, cash balance plans, and so forth. There is no guidance for determining qualifying FICA replacement plan status of the newer and evolving types of plans. NCSSSA recommends that the Treasury Department/IRS prioritize new or revised guidance for these non-traditional plan types.

The new or revised guidance should also address the fact that existing guidance for defined contribution plans of 7.5 percent combined employer, employee, or both does not appear to be an actuarial equivalent to the benefit provided under the Social Security program, the latter of which has a 12.4 percent combined contribution (both employer and employee equally contributing half). The use of 7.5 percent as the minimum contribution threshold appears to rely on the Employee Retirement Income Security Act (ERISA), which does not apply to state and local government employees. It should further clarify use of the terms “qualified” participant in a public pension plan yet current Treasury Department/IRS guidance refers to the requirement that public employees are members of a qualifying FICA replacement plan. NCSSSA has reduced the confusion between “qualified” and “qualifying” by using the phrase “FICA replacement plans.” NCSSSA urges the Treasury Department/IRS to adopt a similar approach to reduce the confusion over use

of those terms. NCSSSA supports the recommendations made by the ACT Committee related to this issue (see footnote 6).

5. **As noted above in the “Challenges” portion of this testimony, the SSA, IRS, and NCSSSA should recommit to the principles and purposes of the Section 218 Council.** Many of the areas of concern NCSSSA has outlined can be ameliorated, if not completely eliminated, if the Council becomes a more robust communication and problem resolution forum. The Council’s purpose statement is:

“The Council will serve as a forum to increase communication between the federal agencies and state administrators, provide a venue in which to raise and address developing issues, and facilitate feedback regarding ongoing efforts to address State concerns. The Council will also attempt to reduce administrative burdens by fostering coordination between agencies; reinforce knowledge and understanding of Section 218 policy and mandatory regulatory provisions; and emphasize the importance of education and training for State and local government employees.”

Adoption and editing of regulations and policies by the SSA and the Treasury Department/IRS associated with state and local government coverage and FICA tax compliance should involve preliminary discussion with NCSSSA so the states’ perspectives can be taken into account prior to any federal agency or department taking formal action. Such an approach will reduce expenditure of taxpayer funds long-term because the states can help our federal partners recognize and address implementation issues that will otherwise be created if the SSA and IRS act independently. The Section 218 Council’s charter can readily be amended to permit such involvement by NCSSSA. In fact, it would be best if Congress authorized establishing the Section 218 Council as another federal advisory committee pursuant to the Federal Advisory Committee Act (FACA). Obviously, the final decision would still remain with either the SSA or Treasury Department/IRS on any proposed federal regulation that would be vetted through the *Federal Register* process or federal policy.

Beware of Unintended Consequences

NCSSSA wants to advise Congress and our federal partners of actions associated with state and local coverage that could have devastating negative unintended consequences. We want to highlight two such areas, both of which are closely interrelated:

1. **We oppose repeal of the voluntary Social Security Coverage (Section 218 of the U.S. Social Security Act) statute for state and local government employees – commonly referred to as universal Social Security.** NCSSSA urges Congress to be wary of the many unintended consequences that would occur if Social Security was mandated for all non-Social Security covered public employees.⁸ We affirm our support for and confidence in the Social Security system. However, we wholly support Old Age-Survivor-Disability Insurance (OASDI) coverage for governmental employees on the lawful voluntary basis as enacted in Section 218 of the U.S. Social Security Act, as amended.

This stance is based on the following major reasons: (a) preserves the integrity of the Tenth Amendment to the U.S. Constitution and state sovereignty that was guaranteed by that amendment; (b) the Omnibus Budget Reconciliation Act (OBRA) of 1990 required Social Security coverage for any employee not covered by a voluntary Section 218 Social Security Agreement or a public pension plan so basic protections are already ensured for all public sector employees, thereby precluding the need for Congress to mandate full Social Security coverage to protect such workers; and (c) negative financial implications for state and local governments and pension plans (e.g., undermining of the retirement security of public employees since the Social Security replacement rate is usually far below that of the vast majority of public pension systems; injuring entire state, federal, and global economies due to reducing available investment capital as many public pension plans would, by necessity, be reduced because most public employers could not afford to pay into both Social Security and also continue their current contribution levels into the existing pension plan designs).

2. **We also oppose federal intervention into, and financial assistance for, public pension systems.** The vast majority of the numerous state- and locally-administered pension systems in the nation are financially

⁸ Some contend, alternatively, that imposition of universal (or mandatory) Social Security coverage on only newly hired state and local government employees would solve financial and complexity issues associated with the Social Security program. That is untrue because there would still be a generation of non-covered public employees who would fall under existing federal and state laws, i.e., all of those hired prior to the date Social Security coverage is mandated for newly hired employees who are only covered by a qualifying FICA replacement pension plan.

sound and well managed. Most state and local government pension plans do not want, nor need, federal financial assistance. In fact, many public pension systems are in better financial shape than are either the Social Security or Medicare Trust Funds.

Due to the existence of Section 218 of the U.S. Social Security Act, public employers and employees already have the ability to obtain Social Security coverage voluntarily. Those who desire to augment their existing public pension plan with Social Security can do so by contacting their State Administrator and requesting a referendum election voted on by eligible public pension plan members. If approved by the referendum election voters, Social Security coverage is granted to affected employees by way of approval of a Modification to that state's master Section 218 Agreement with the SSA.

Properly administered and pre-funded defined benefit pension plans provide for adequate retirement security thereby preventing their members and beneficiaries from having to get assistance from the public welfare system. The National Institute on Retirement Security (NIRS) documented that in 2014 public and private sector defined benefit plans paid nearly \$477 billion in pension benefits to 24 million retired Americans.⁹ In fact, such public pension systems are actually significant economic engines for the total economy.¹⁰ The analysis found that the benefits provided by state and local government pension plans have a sizable impact that ripples through every state and industry across the nation. Further, according to the U.S. Census Bureau, during 2012, those public pension systems represented more than 19.6 million members and nearly 9.0 million beneficiaries who received periodic benefit payments totaling \$225.2 billion.¹¹

Conclusion

By having Congress, the Administration, the Treasury Department, SSA, IRS, and NCSSSA working together we can assure that state and local coverage, under the law, is handled properly while remaining true to the Tenth Amendment of the U.S. Constitution. This is accomplished by continuing to allow each state to choose the combination of public pension plan and Social Security coverage or both a pension plan and Social Security coverage for its public employees. NCSSSA's members can assist IRS and SSA in reducing and preventing future problems by, for example, advising all state and local governments of the issues and concerns that are identified, and by focusing NCSSSA's trainings and future Annual Conference topics on these issues.

As issuance of IRS Publication 963 in 1995 showed, such cooperative efforts by the federal government and the State Administrators can reduce payroll tax enforcement and Section 218 administration costs by generating improvements in voluntary compliance by state and local governments with all applicable federal and state laws.

Thank you for inviting NCSSSA to testify on behalf of the states and their political subdivisions.

⁹ NIRS conducted a number of studies related to the financial impact of defined benefit pension plans. They concluded that a typical defined benefit pension plan provides equivalent retirement benefits at about half the cost of a typical defined contribution plan, and 29 percent lower cost than an ideal defined contribution plan that is modeled using very generous assumptions. See: William B. Forna, FSA, and Nari Rhee, PhD, "Still a Better Bang for the Buck : An Update on the Economic Efficiencies of Defined Benefit Pensions", published by the National Institute on Retirement Security, December 2014, available at: http://www.nirsonline.org/index.php?option=com_content&task=view&id=871&Itemid=48 . Other NIRS studies of interest can be found at: http://www.nirsonline.org/index.php?option=com_content&task=blogcategory&id=70&Itemid=49 and relevant NIRS Issue Briefs at: http://www.nirsonline.org/index.php?option=com_content&task=blogcategory&id=70&Itemid=49 and general information on the National Institute on Retirement Security is available at: <http://www.nirsonline.org/> .

¹⁰ National Institute on Retirement Security. "PENSIONOMICS 2014: Measuring the Economic Impact of State and Local Pension Plans" available at: http://www.nasra.org/files/Topical%20Reports/Economic%20Effects/pensionomics2014_final.pdf. NIRS also documented that Defined Benefit public pension benefits have a significant economic impact: 6.2 million American jobs and \$943 billion in economic output and paid nearly \$477 billion in pension benefits to 24 million retired Americans and beneficiaries.

¹¹ State and Locally-Administered Defined Benefit Pension Systems - All Data by State and Level of Government: 2012, 2012 Census of Governments: <https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk> .

Chairman Johnson. Thank you. I thank you for your testimony.

We will turn to questions now. As is customary for each round of questions, I will limit my time to 5 minutes, and I will ask my colleagues to also limit their questioning time to 5 minutes as well.

Ms. LaCanfora, this clearly is a complicated topic, and I want to be sure we all understand Social Security's role in this process with a few yes-or-no questions. Our time is limited, so just answer yes or no, if you can.

Is Social Security responsible for making sure that workers receive the correct Social Security benefit amount?

Ms. LaCanfora. Yes.

Chairman Johnson. Is the amount of benefit a worker receives based on his average lifetime earnings?

Ms. LaCanfora. Yes.

Chairman Johnson. And to determine a person's benefit accurately, does the person's earnings record need to be correct?

Ms. LaCanfora. Yes.

Chairman Johnson. You have said yes to these questions, and it is clear that earnings information is the basis for the most important thing Social Security does, paying the right amount of benefits to the right person. Yet, in your testimony you say Social Security's role in the 218 coverage and compliance process is limited.

Why is your role limited when these processes are at the very heart of your mission when it comes to correctly paying benefits for State and local workers?

Ms. LaCanfora. Our role at the Social Security Administration is limited only to the extent that we cannot operate alone. But our role is both substantive and integral to making this process work. We just have to do so in conjunction with the IRS and the State Administrator.

Chairman Johnson. So you think the IRS -- does the IRS have a collar around your neck?

Ms. LaCanfora. I wouldn't say that, no. I would say it is a partnership between the three entities that are here testifying today. I think Dr. Motza in her testimony said that the State Administrators have a profoundly important role, and I would agree with that. the State Administrator role is sort of the lynchpin to making this process work. But the Social Security Administration, as I said, also has a very substantive integral role that we take very seriously.

Chairman Johnson. Okay. Do you think the system is working properly right now?

Ms. LaCanfora. I think, as you will find out through this hearing, the statutory construct is extremely complicated, making it a challenge to administer perfectly, and thus, employers do make mistakes in this area. And I am sure that we can all improve. But I think we are all doing due diligence to make sure that we are having this process work as well as possible.

Chairman Johnson. Thank you.

Ms. LaCanfora, the bedrock of Social Security is that an earned benefit, workers pay taxes on their hard-earned wages for the promise of future benefits. But in your testimony you said what matters is that a worker had earnings, not that they properly paid taxes on their earnings. Why is that?

Ms. LaCanfora. The law stipulates that the way in which we credit earnings is based on the money that is earned as opposed to the taxes that are paid.

Chairman Johnson. Well, that has to be a drain on the trust fund since benefits are being paid without taxes ever being received. How often do you think that happens?

Ms. LaCanfora. I don't know how often we have errors, but I think it is safe to say that we uncover them rarely, and when we do, we try to address them in collaboration with our partners expeditiously.

Chairman Johnson. Mr. Larson, do you care to question?

Mr. Larson. Thank you, Mr. Chairman.

I want to thank all of our witnesses as well.

And along the same line of questioning that the chairman had, Ms. LaCanfora, Social Security is widely known as being the most efficient governmental

program that we have. I believe your loss ratio, a term that is used in the private sector frequently, is at 1 percent. Is that correct?

Ms. LaCanfora. That is a fair characterization.

Mr. Larson. Could you explain what that means in terms of the delivery of service and what that means in the private sector? In the insurance industry in the private sector, they say between 70 and 75 percent loss ratio is a good mark to achieve.

Ms. LaCanfora. I think a simple way of explaining it would be to say that our administrative expenditures, that is, the money that it takes to actually run the agency, hire employees, and so forth, our administrative budget is less than 1 percent of our outlays or what we pay out in benefits.

Mr. Larson. That is correct. And along those same lines, and yet, what we have seen consistently is that the budget for Social Security has fallen by 10 percent since 2010, while the number of beneficiaries, primarily the often referred to baby boomers, has increased by 13 percent. Has that placed a strain on the ability of Social Security to administer this very complicated program that we have been talking about this morning?

Ms. LaCanfora. I think, like all Federal agencies, we have challenges. Our objective is really to try to operate as efficiently as we can within the constraints of the budgetary environment, and to try to automate where we can, and to try to improve processes and policies, which I think is what we are trying to do today.

Mr. Larson. Is there anywhere in the private sector where you could pick up an insurance plan that is as comprehensive as Social Security?

Ms. LaCanfora. I am probably not well-qualified to answer that question.

Mr. Larson. Ms. Lough or Ms. Motza, if you want to answer that?

Ms. Lough. I wouldn't know.

Ms. Motza. No.

Mr. Larson. I can answer it for you: There is not. But, nonetheless, I raised that point because this is an insurance program.

The last time there was a premium increase in this insurance program was 1983. I ask everybody in the audience and all of our panelists up here, have any of your other insurance programs gone up since 1983? Have any of you seen an increase in what you have to pay in terms of a premium?

I think we all know what the answer is, it is a resounding yes, they have. And yet, Social Security, what we have managed to do, is cut it back in terms of the services that we provide, while baby boomers are coming through the process.

And we know from previous testimony that oftentimes the best individuals that are equipped to detect fraud are those that are in the front lines, who are in there doing the actual screening of citizens that take up Social Security. That is why, Ms. Motza, you were able to say that you are like a duck that keeps in calm water, but there is an awful lot of paddling that goes on underneath.

The point that I would like to make is this. We do have to continue, and I applaud the chairmen, both chairmen, because we have to be persistent to make sure that we are wringing out any kind of fraud, abuse and waste. But in the process, we shouldn't throw the baby out with the bathwater. Meaning, we shouldn't be cutting back on quality employees that can actually assist and help better navigate these very complicated waters and do it in an efficient matter with a 1 percent loss ratio that also provides these kinds of benefits.

And I think when there is a final examination about what insurance is, and to look at the fact that there hasn't been an increase since 1983, and to understand that if you were making \$400,000 a year, about six-tenths of 1 percent of the American people do, it would cost you less than this Starbucks latte to make Social Security solvent into the next century. And I know that is a goal of everybody on this committee.

It is our goal on this side to talk about how we make it more efficient, how we root out any kind of fraud and inefficiencies, but how also we expand this program, the most efficient Government program that is run, so that it assists the American people in a way that they have become accustomed to, so that no one, especially women, can retire into poverty, that they got the COLA that they deserve. And, yeah, even so that many seniors, because we haven't indexed this right, get a tax break as well.

And with that, I will yield back my time.

Chairman Johnson. Thank you.

Mr. Buchanan, you are recognized.

Chairman Buchanan. Thank you, Mr. Chairman.

And I want to thank our witnesses today.

Ms. LaCanfora, let me mention, you said, just so I get a sense of this, you said that there are 23 million people part of this program, now there are 6 million. Explain exactly what you mean. There are six million who are still involved where the funds are being managed on a state or a local basis? Is that what you are referring to?

Ms. LaCanfora. There are 23 million people who are State or local employees in total.

Chairman Buchanan. Okay.

Ms. LaCanfora. Of that 23 million, about a fourth of them, about 6 million, are not covered by Social Security. And the reason for that is because the law gives States discretion about which of those public employees to cover or not to cover, and there is a wide variety of different scenarios across the states.

Chairman Buchanan. Okay. So they are paying into some various state, county. Who is managing the funds?

Ms. LaCanfora. Well, all of the public pension systems at the State level are different. Some of them are statewide, some of them are not, so there is great variation there.

Chairman Buchanan. How big of a problem do you think there is? I mean, with someone managing the fund, let's say someone puts in their -- 35 years they pay in -- I grew up in the Detroit area and Detroit went bankrupt -- what happens to the funds and what risk does the federal government have if somehow it is mismanaged or the funds there aren't for a worker's retirement?

Ms. LaCanfora. I think that might be a question better addressed by the IRS.

Chairman Buchanan. Okay. Well, let me ask you.

Ms. Lough. So the State employees, if they are covered by a qualifying public retirement plan and they don't have a 218 agreement, they don't pay into Social

Security. So the question I think is whether the plan is a qualifying retirement plan or is it solvent? I think that is the question.

Chairman Buchanan. The question is, is it solvent? It is kind of like what we did with Social Security in the mid-1960s, we commingled the funds into general funds and we have a trust fund but there is no money in there. What happens locally if it gets mismanaged, there is not the funds? What responsibility does the federal government have with those workers?

Ms. Lough. Just like any other qualifying plan, if it is covered by the PBGC or -- it is a question of whether it is -- it is fully funded is --

Chairman Buchanan. In other words, if you have six million people with their funds are being managed at the state or local level, if somehow they don't get what they expected or what was going to be paid out to them over time -- that is what happened in the Detroit area, my understanding -- what happens, what responsibility does the federal government have, if any?

Ms. Lough. So the IRS looks at the plans to see if they are run properly according to the requirements of the Tax Code. But if the funds are not properly funded, the responsibility is outside the IRS' purview.

Chairman Buchanan. Ms. Motza, let me ask just quickly. You mentioned about the firefighters as one example. How big of a problem is it for these six million workers?

I am concerned that at the end of the day they paid in, their employer probably paid in, there was some kind of match, those funds need to be managed, you want to make sure it is there. I agree with my friend, Mr. Larson, that Social Security, I think, is one of the best programs on the planet. You can count on it.

I am worried, frankly, about cities, counties, and states mismanaging funds and there being some question about whether they are going to get paid out. I have seen that happen on a local level. So I wanted to get your sense of it. How big of a problem or challenge is this?

Ms. Motza. Thank you, Chairman Buchanan. I would be happy to address it.

I actually -- one of my hats I wore before I retired from the State in January was to serve as a trustee for the Colorado Public Employees' Retirement Association, the biggest public pension plan in Colorado and one of the biggest

in the Nation. And we recognized when the financial downturn occurred that the way the benefit structure was configured and the contribution rates were configured, we couldn't sustain it. And so we actually went to our State legislature, we came up with a game plan --

Chairman Buchanan. We are going to run out of time. I want to ask you one other question along those lines.

Ms. Motza. Okay. But basically most pension funds in the Nation are not in dire straits. Unfortunately, Illinois is one of the worst --

Chairman Buchanan. Okay. But let's say Illinois has got a problem. Do they look to the federal government? Does the federal government, in your opinion, have liability if somehow it gets mismanaged for a worker in Illinois?

Ms. Motza. Not that I know of under current law.

Chairman Buchanan. Thank you. I yield back.

Chairman Johnson. Thank you. Good question.

Mr. Lewis, you are recognized.

Mr. Lewis. Thank you very much, Mr. Chairman.

Let me thank each of you for being here and for your testimony.

My question is for the panel, for each one of you. I understand that the Tax Code, Section 6103, does not allow the IRS to share the name with the local government, the State Administrator when requesting information to ensure payroll compliance, tax compliance.

Would each of you please share with us how the law makes compliance difficult?

Ms. Lough. Section 6103 of the code, you are absolutely right, doesn't allow us to share -- unless there is an exception in there -- specific taxpayer information with other Federal agencies. But there is an exception in 6103 for us to share information with the Social Security --

Mr. Lewis. You said there is an exception?

Ms. Lough. There is an exception under 6103(l) for us to share that with the Social Security Administration, and we do share information when it becomes necessary with the Social Security Administration with regard to specific public employers. But we are not permitted to share that with the State Social Security administrators.

Mr. Lewis. Ms. Motza, would you like to comment?

Ms. Motza. Yes, please. This is an area that has been problematic ever since 1987, since the Federal responsibility for FICA tax collection went to the IRS, and previously State and local government contributions to Social Security were collected by the State Administrator.

NCSSSA believes that it was inadvertent oversight when the Treasury regulations related to 6103 were adopted, because when 6103 was originally adopted by Congress, the State Administrator was collecting the contributions. So it wasn't even thought that they would need to have them carved out as a separate classification.

The fact that IRS cannot talk with State Administrators and find out what information we have, which is extensive in our records, we have lots of interpretative documents and legal opinions that don't exist anywhere else. As a matter of fact, many of our public employers think that the 218 agreements and documents they have can be thrown out. We know they can't be, they are permanent binding agreements and all the important information is in those files.

The IRS when they are -- because of 6103, they can't reach out to us and find out all the coverage requirements for that particular entity. It would be far more efficient and effective for everybody, including the Federal and State and local governments, as well as save taxpayers' dollars, if the IRS was able to contact the State Administrator initially, find out exactly what the coverage requirements are under that particular 218 agreement, and also the particular pension systems that exist in that State, and any other nuances that exist. They can't do that.

So it has really been a significant hampering of the efficiency and effectiveness of administering this program, in my opinion.

Mr. Lewis. So you are suggesting that as Members of the Congress and members of the Ways and Means Committee, we can fix it?

Ms. Motza. You can fix it. You absolutely can, and we would definitely appreciate it. And we would encourage you to work with the Treasury Department and NCSSSA and all of us. And I think everybody on this panel would recognize that that would be a vast improvement because it would make all the difference. It would save tons of time and effort, and it would reduce the error rate dramatically, I am convinced.

Mr. Lewis. The other two members of the panel, are you prepared to say yes?

Ms. Lough. So implementing the tax law, we implement the law as currently written. If it is a matter of policy we defer that to the Treasury Department.

Mr. Lewis. Thank you very much.

Do you want to respond.

Ms. LaCanfora. I think my colleagues summed it up well. I would say generally that information sharing is absolutely critical to making this process work well.

Mr. Lewis. Thank you. I yield back.

Chairman Johnson. Thank you. Thanks for your question.

Mrs. Walorski, you are recognized.

Mrs. Walorski. Thank you, Mr. Chairman.

Thank you to our witnesses for being here and lending your expertise, I appreciate it.

Ms. Lough, I just wanted to walk back through your testimony to make sure I understand exactly what we are talking about here.

When the IRS receives tax information for a public employee, does the IRS know whether the employee is covered by Social Security? And then my question is, if not, so is there additional information that could help? And how would the IRS or other parties go about getting or setting up that line of communication? Is it just the line of communication that you are talking about here between the sharing that you have done? Help me understand.

Ms. Lough. So the IRS receives from the employers Form 941 and W-3 statements, and we can match to look to see if the amounts that are listed on the 941 and W-3 match. We also get W-2 returns for each employee. And based on the percent of Social Security listed on the W-2 and the wage amount, we can guess whether the employee has paid the correct amount of Social Security.

But my office looks at the 941s and W-3 because we have jurisdiction over the employers, not the employees. And so we look at that, and if there is a mismatch between what they told us in the 941 and the W-3 filed, then they get an automatic reconciliation notice, depending on the difference between the mismatch.

But we also look at the 941s and W-3s to see why there is less Social Security or the percent is so little. And then we look to see, in our database that Marianna just talked about, whether there is a 218 agreement or not. And based on those filters, we make a determination whether the employer may be potentially noncompliant, and we reach out with regard to some compliance action, which could be a compliance check or an audit.

But on the face of the returns, we can't with certainty tell whether all the employees of that public employer were appropriately covered or not.

Mrs. Walorski. You can or can't?

Ms. Lough. Cannot.

Mrs. Walorski. Cannot. Okay. So short of an audit that you just mentioned, you really don't know whether an employer reported and paid the correct amount of FICA taxes without an audit? And is an audit the only fail-safe mechanism here?

Ms. Lough. Short of an audit, that is the only way for us to know certainly, by 100 percent certainty whether the employer is covering all the employees appropriately.

But we do provide extensive outreach, and we have a questionnaire and an assessment tool that the employers can use to have a checklist to make a determination whether a group of employers should or shouldn't be covered. We do webinars.

And for the most part, this is a very compliant employer base. If they do make errors, like my colleague from Social Security Administration said, most of the time it is because of the complexity of the laws and the lack of understanding.

In my opinion, there is no aggressive noncompliance or trying to hide. It is basically an education up front by all of us, and also an audit at the back end to do the checks.

Mrs. Walorski. So since there is not an audit on every single person, since you do some of the sharing of information back and forth, and it is the result of this massive complexity of how this thing is tied together, which I think reiterates, again, how badly we need reform in a much more simple kind of system than we have now, so short of an audit there is really no way to tell for sure if these records actually match.

And what do you think the error rate is, I mean, that comes through your office? Is it 10 percent of people that never get matched up? Or is it 5 percent of people that don't get matched up and don't have an audit? How many just percentage do you think are out there where we never actually get this right?

Ms. Lough. I really don't have the percent. I will be happy to get back with you on the exact change rates that we have in an audit. But I do want to reiterate that the changes we do see are generally as a result of not understanding the rules.

WALORSKI:

.... But, so short of an audit, there's really no way to tell, for sure, if these records actually match and what you think the error rate is, I mean, that comes through your office? Is it 10 percent of people that never get matched up or is it five percent of people that never -- that don't get matched up and don't have an audit? How many, just percentage, do you think are out there where we never actually get this right?

LOUGH:

I really don't have the percent. I'll be happy to get back with you on the exact change rate that we have, in an audit.

Public as well as private employers are responsible for reporting Social Security coverage on Forms 941 and W-3, which are mechanically matched. For both public and private employers, Federal Insurance Contributions Act (FICA) and unemployment tax are about 3 percent of the tax gap for under-reporting (TY 2008-10 annual average).

<https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>, Table 2.

The IRS audited approximately 0.6 percent of all returns (including income, employment, and other taxes) filed in CY 2015. IRS Pub. 55-B, *Data Book* (2016) at pg. 21, <https://www.irs.gov/pub/irs-soi/16databk.pdf>.

Each year, the IRS Federal, State & Local (FSL) function selects for audit a few hundred from tens of thousands of public employers. In FY 2016, of 362 audits, FSL proposed adjustments to taxable wages in 254, 78 of which related to FICA, including but not limited to Section 218 coverage.

Mrs. Walorski. Of the complexity, right?

Ms. Lough. The complexity of the laws. And not only the complexity, but also the various timings in which the laws came and when the employer came on board -- the employee came on board. So that makes a difference also.

Mrs. Walorski. I got it and I appreciate it.

Thank you, Mr. Chairman, I yield back.

Chairman Johnson. Thank you.

Ms. Sanchez, do you care to question?

Ms. Sanchez. Thank you, Mr. Chairman.

And I want to thank the witnesses for being here today to provide us with some insight as to what you deal with.

Social Security lifts many millions of Americans out of poverty, and after a lifetime of hard work, every American deserves the peace of mind to know that they are going to be able to retire with a little bit of financial security and a little bit of dignity.

For 94 percent of American workers, knowing that Social Security is going to be there when they retire is a great peace of mind that they can carry with them. But Social Security generally doesn't cover State and local employees.

For example, in my home State of California, there are 1.3 million Californians who are not covered by Social Security, who likely participate in the California State Retirement Plan or CalPERS, as it is known. For them, knowing that CalPERS will be there in retirement provides them with the same sense of security.

But there are cities or school districts that can sign agreements with the Social Security Administration which specify that certain State and local employees will be covered by Social Security. And these agreements might say that principals are not covered by Social Security, but administrative staff is. And so they can get a little complicated. And the IRS is tasked with enforcing these agreements, but they aren't always able to take proactive steps if they think that there is a problem.

I know that this particular case happened in D.C., but I can't imagine how troubling it would be for a worker to find out that after 10 years of work they had not been paying into State retirement or into the Federal Social Security program. And I am glad that D.C.'s own audit discovered that and they quickly corrected that.

Most of us here today just want to make sure that this isn't happening in our districts or that our constituents aren't similarly affected by technical mistakes like this. And it is our job to try to figure out ways to make it easier to identify these issues early on to prevent that kind of situation from happening again.

So I will begin with Ms. Lough. In the 218 agreement assessment project the IRS identified some risk areas. I understand that the IRS can't work directly with the State Social Security agencies. So how does the IRS handle those situations? What kind of proactive steps is the IRS able to take? And are you able to inform the cities so that they can take some remedial action?

Ms. Lough. With the risk areas, our first step is to try to educate and do outreach on areas where we see that employers are having noncompliance as a result of not understanding the rules. So we do webinars. We have very robust education tools on our IRS.gov. And we also have a Desk Guide that we have. It is pretty lengthy. We worked with the Social Security Administration on the Desk Guide, which is on our website.

And then we have approximately 50 agents that are spread throughout the country.

They build good relationships with their State Social Security Administrators and the employers, and they are available to answer questions when employers have those questions. Although we can't talk to State Social Security Administrators about specific taxpayers, we do have conversations with them on general questions when they reach out to us. We have quarterly meetings with the Social Security Administration. Regularly, we attend meetings with the National Council of State Social Security Administrators. So our first preference is always outreach and education.

Ms. Sanchez. Okay. Do you know roughly how many 218 Agreements the IRS helps to administer?

Ms. Lough. We are not party to the 218 Agreements. We just get copies, and we look at them to see who is covered or not. So I wouldn't know the answer.

Ms. Sanchez. You don't have an answer.

Can you just tell me, in the little remaining time that I have, how have budget cuts impacted your agents' ability to perform compliance check?

Ms. Lough. So resources are always an issue. We have had attrition in resource, but we do the best we can. And as I stated, the best way to make sure there is voluntary compliance, which is the Federal tax system, is that employers voluntarily do their correction and comply with the rules of education and outreach. So we do that with the best use of resources, like doing a webinar. Do it once and put it out so people can listen to it. And so resource is always an issue, and we try to allocate them appropriately.

Ms. Sanchez. Great. Thank you so much for your testimony and for your answers.

And I yield back.

Chairman Johnson. Mr. Bishop, do you care to question?

Mr. Bishop. Thank you, Mr. Chairman. Yes.

Ms. Motza, I understand that, under section 218 of the Social Security Act, State/local governments may extend social security benefits to their employees. Can you give us more information about exactly what a 218 agreement is, what is in it, and what type of information is included in an agreement like that?

Ms. Motza. Certainly. I would be happy to.

The basic information is that the section 218 agreement with each State was entered into originally, usually in the fifties. And that is what we commonly call the 218, Main Master 218 agreement. Modifications to that agreement are made to add employers and their employees.

The agreements are contracts effectively between the State and the Social Security Administration. No individual State or local government can enter into a 218 agreement independent of going through the State, because of section 218 of the Social Security Act. And that is why the State Administrator is such a key liaison with administering those.

The agreements basically outline that the employer understands and appreciates that, since 1983, once they enter into a section 218 agreement, it is a permanent, binding agreement. They can no longer withdraw. Prior to that, they could withdraw from coverage with the 2-year period and approval from Social Security Administration.

It includes what positions that are employed by that employer are to be covered under Social Security. Sometimes there are optional exclusions that they choose. Some of the most common ones are student optionally excluded. And there are obvious things, like mandatory exclusions, that are just in Federal law. Like emergency workers during a flood, for example, are automatically excluded. It includes the effective date. It includes, you know, basically, you know, typical terms and conditions of a contract, saying, going forward, this is how it is going to be.

And then we submit the agreements. The State Administrator does all the work up front, works with the employer, educates them about what they need to know to make an informed decision, because of the mandatory Social Security provisions of OBRA-90. And that they don't have to be permanently bound to Social Security if they fall under OBRA-90. So, basically, it is a contract that outlines, you know, who is covered, who is not, and effective dates and agreeing to be taxed.

Mr. Bishop. Okay, thank you for that. So there are a lot of subentities, local governments. Each State has one agreement then with several sub --

Ms. Motza. It is a master agreement that has been modified over the years. For example, in Colorado, where I am from, there are about 750 agreements. There are States -- I can't think of some of the numbers, but, you know, there are States, like the GAO report in appendix II documented that virtually every public employee in Vermont -- there are some exceptions -- is covered under, you know, Social Security.

Mr. Bishop. But it is one agreement per State, and then subsections to each.

Ms. Motza. There is one -- that is exactly right, yes, uh-huh.

Mr. Bishop. What triggers a modification? Exactly what is the process?

Ms. Motza. It can be a variety of things. It can be a change in State law, for example, where a -- let's say a State that has added a new pension plan, they decide that, in addition to the pension plan, they also want Social Security

coverage. So, in that case, the State Administrator would amend or modify the agreement.

Mr. Bishop. Okay, thank you. That is helpful. I have so little time, but --

Ms. Motza. I know.

Mr. Bishop. -- I would love to hear more.

Ms. Lough, a 2010 GAO report on Social Security coverage for the State and local governments noted that the IRS has a database of public employees. I just wondered how the Social Security Administration validates that database and what it is used for.

Ms. Lough. So we have a database, like my colleague from Social Security Administration said, of the modifications and the master agreement. So we know, to the best that we can, when we are provided the modifications every time there is a modification that occurs, but we can't be 100 percent certain we have all of them. So we have created a database. And if there is a mismatch, if the 941 shows very little Social Security coverage, we look to see if there is a 218 agreement or not, whether we should do a compliance action or not. Now, we don't validate with the Social Security Administration. It is a matter of resources for the Social Security Administration and IRS to go over that. Given the fact that this is a largely compliant taxpayer base, it just comes down to resources.

Mr. Bishop. Thank you.

And I yield back, Mr. Chairman.

Chairman Johnson. Thank you.

Mr. Pascrell, you are recognized.

Mr. Pascrell. Thank you, Mr. Chairman. Great to see you.

Mr. Chairman, I want to commend this panel, particularly when public employees have been under so much of an assault -- I mean assault -- over the last several years. You come before us, objectively, knowing that everybody on this panel is on some bill or other to cut waste and fraud in government. That is a given. But you stood tall today.

I really appreciate what you have done and what you are doing. And at the same time, we know that the Social Security Administration's phone service has so deteriorated over the last 10 years. Why? Because they don't have enough people. I mean, they didn't decide to talk to one another and say: I will only take two phone calls today; I will be busy the rest of the day.

No, they have their schedule every day, I know this.

So, to get back to the major topic, retirement security is essential for all Americans. I think Mr. Larson pointed that out dramatically. For those workers who rely on retirement funds other than Social Security, which you are talking about today, they need that certainty. They need predictability about their retirement income. So ensuring compliance with agreements about how State and local government employees participate in Social Security can help provide this certainty.

In order to have robust oversight of compliance, you have to have well-trained personnel in place to do it. You have got to have training programs. You have got to make sure that people participate in those training programs.

So this is not a sexy discussion today. I don't know if the media will even cover it, because to them, it is immaterial because it is not sexy. But this is critical to a lot of people. And I thank you for what you are doing. Many times I have said this: In the context of the IRS, Medicare, Social Security, my friends on the other side -- and I call them my friends, and they know that -- cannot continue to make deep cuts in agencies' operating budgets, or the resources, and simultaneously expect to have a world-class service. That is what we want. That is what you are capable of. So training for the administration of State and local coverage and tax compliance is critical.

Dr. Motza, let me ask you this: In your written testimony, you discuss a shift in the training in section 218 and the oversight in many States as well as within the SSA and the IRS. You attribute these changes to funding reductions.

Can you discuss the shift and give us a sense of how it has impacted the quality of this training?

Ms. Motza. Thank you, Congressman.

Yes, I would be happy to. The lack of resources at SSA and IRS, because of limited funding, has dramatically impacted their ability to help State and local

government employers and employees comply voluntarily. And as Ms. Lough indicated, it is a group that wants to comply.

Mr. Pascrell. You provided in your written testimony, you made certain recommendations.

Ms. Motza. Absolutely. We would like to see --

Mr. Pascrell. Tell us all.

Ms. Motza. We would like to see grants from Congress that go to the States, SSA and IRS, so that we can conduct ongoing education outreach to make sure that these employers and employees know exactly what they need to do, when and how to do it. And they will comply. When Pub 963, IRS Pub 963, the Federal-State Reference Guide, was first published in 1995, IRS documented that, within the next 4 years, voluntary contributions to the Social Security and Medicare trust funds skyrocketed. That is important.

Mr. Pascrell. Yes. I want to thank the gentleman from Georgia who brought up the question about -- and you will elaborate on -- 6103, which is my favorite part of the Tax Code. I wonder why.

Ms. Motza. It is certainly not our favorite.

Mr. Pascrell. I know. Thank you.

Ms. Motza. Unless you change it.

Mr. Pascrell. Thank you.

Chairman Johnson. Mr. Rice, you are recognized.

Mr. Rice. Ms. Motza, who do you work for?

Ms. Motza. I am gloriously retired. I worked for the State of Colorado for over 41 years. And yes, I was hired before child labor laws went into effect. That is why. But -- that is a joke.

But I am here representing the National Conference of State Social Security Administrators, because I was the State Social Security Administrator for nearly 24 years for Colorado.

Mr. Rice. Who do the State -- who does the Colorado State Social Security Administrator work for?

Ms. Motza. It is actually in the Labor and Employment Department. It was placed there as a fluke. There was 2 years, my understanding, at the beginning of the 1950s, when the Social Security Administration at the national level was under the U.S. Department of Labor. So I think the State legislature there just took the easy out and said: Well, let's throw it in the Labor Department.

Mr. Rice. So that is the Colorado State Labor.

Ms. Motza. Colorado State Labor and Employment.

Mr. Rice. Not Federal, it is the State. You work for the State.

Ms. Motza. It was the State. It is part of the State, yes. Department of --

Mr. Rice. So do all of the State Social Security Administrators work for the various States and not the Federal Government?

Ms. Motza. Absolutely. And we want to keep it that way, because of the 10th Amendment. The independence and State sovereignty is important. Each State was given the option, under the Social Security Act, based on section 218, to determine what the configuration of coverage for their employees, their public employees was --

Mr. Rice. What is the function of the State -- does every State have a State Social Security Administrator?

Ms. Motza. They are required to under Federal law. Unfortunately, because of funding cutbacks and since the transfer of responsibility for collecting contributions in 1987, a number of States, I am sad to say, no longer take that job seriously. And that is one of the things we would encourage Congress to help us with. We would appreciate a resolution or something that gives us clout to say to State officials that this is a vital and critical role, an important role that helps not only the public employers and employees, but taxpayers.

Mr. Rice. So not every State has one.

Ms. Motza. They do have a named official. But are they active? Not necessarily.

Mr. Rice. All right. So Federal law requires that every State have at least one, but they are not paid for by the Federal Government.

Ms. Motza. No. They are --

Mr. Rice. So, in some States, you say there is only one person that works for this entity, this group. And in other States, do they have big staffs?

Ms. Motza. No. In most -- they used to have big staffs when they were collecting the contributions, but most State officials, it is one or two people. And in very many States, it is a portion of a job. It has been really relegated to --

Mr. Rice. You are saying some folks don't even have a full-time person.

Ms. Motza. No, many do not have a full-time person.

Mr. Rice. And it is the job of this position to be an intermediary between the Federal Government and the State and local governments?

Ms. Motza. Absolutely. And to know exactly what is going on at the Federal level and within their own State to make sure that they are reconciling and they are staying compliant.

Mr. Rice. When you did it, was it a full-time job?

Ms. Motza. Part of the time, it was a full-time job. Other times, I was wearing other hats.

Mr. Rice. Did you, in the course of your undertaking this activity, frequently find municipal governments and county governments that thought they were complying with the law but weren't, as we have discovered here of late?

Ms. Motza. Yeah. And we -- early on, when I took on the job in 1993, I was very fortunate to have an excellent executive director of that department who did training and outreach.

Mr. Rice. So that was a frequent thing that you found people --

Ms. Motza. It wasn't frequent, but it was enough --

Mr. Rice. Was it once a year, every 2 years, every 3 years?

Ms. Motza. Pardon me. I am sorry?

Mr. Rice. Was it annually that you found somebody who thought they were complying with the law?

Ms. Motza. Initially, yes. And then, again, once Pub 963 came out and they had a clear understanding of what was necessary and appropriate, the noncompliance was less. And we were doing education and outreach jointly with IRS and Social Security that really enhanced the improvement rate.

Mr. Rice. All right.

Ms. LaCanfora, IRS does most of your compliance testing, right?

Ms. LaCanfora. I am sorry, can you repeat the question?

Mr. Rice. The IRS does most of your compliance testing, is that correct?

Ms. LaCanfora. That is correct.

Mr. Rice. I am out of time.

I yield back, Mr. Chairman.

Chairman Johnson. Well, thank you. You can go ahead and get an answer to that question, because I would like to hear it.

Mr. Rice. Well, my next question was going to be, the way that you determine whether or not somebody's in the Social Security system is just from their 941s and their W-2s. Is that right?

Ms. LaCanfora. As Ms. Lough described, there is a reconciliation process to determine whether the employee wage reports match up with the employer tax return.

Mr. Rice. Well, here is my question: Do you have cases with relative frequency where people have not had Social Security withheld from their paycheck and that you determined that it should have been and you go ahead and pay them their Social Security benefits?

Ms. LaCanfora. Not with relative frequency, no.

Mr. Rice. Okay. Thank you.

Chairman Johnson. Thank you.

Ms. DelBene, you are recognized.

Ms. DelBene. Thank you, Mr. Chairman, and thank you to all of you for being with us today.

For more than 80 years, Social Security has kept seniors out of poverty and provided a vital safety net for our middle class. But, unfortunately, due to a legal technicality, Tribal governments are currently prohibited from entering into agreements with Social Security Administration to allow their elected leaders to participate in the program. This makes elected Tribal leaders one of the few classes of Americans that are prohibited by law from paying into Social Security and receiving benefits from it. I believe that is unfair and punishes Tribal members who wish to give back to their people through government service. And that is why I, along with my colleague Congressman Reichert, my Washington State colleague Congressman Reichert, introduced the Tribal Social Security Fairness Act earlier this year, allowing elected Tribal leaders to opt into the Social Security program.

There is really no reason the same benefit shouldn't be extended to Tribal leaders who choose to participate, putting them on par with pretty much every other American.

And so, Ms. LaCanfora, I assume you are very aware of this issue, and could you tell us how you feel about allowing elected Tribal officials to be able to participate and contribute to the Social Security system in the same manner as every other American?

Ms. LaCanfora. I think you explained it very well. The legislation that you are referring to would allow Tribal governments to voluntarily opt into Social Security coverage, and we would be happy to work with the committee to provide any technical assistance you may need.

Ms. DelBene. And do you agree that this is a technical issue, in terms of why they have been excluded?

Ms. LaCanfora. I think there could be views on various sides of the issue. And I don't think we have a particular position on it, but we can certainly provide assistance as needed.

Ms. DelBene. I want to thank -- both the IRS and the Social Security Administration have provided technical assistance to the drafting of legislation we put together.

Ms. Lough, do you believe this legislation or legislation like this would have a positive impact on Indian country?

Ms. Lough. I defer. That is a policy issue, and I defer that to the Office of Tax Policy. And we are willing to work with them to implement anything that is enacted.

Ms. DelBene. Thank you. This legislation is really about equity for Tribal nations and removing barriers from talented native leaders who really wish to serve their communities. And all Americans, I think we can all agree all Americans deserve to retire with dignity and economic security.

And I will continue to work in a bipartisan fashion, like this legislation was put together, to advance forward-looking reforms to improve Social Security for all Americans.

Thank you for your time, and I yield back.

Chairman Johnson. Thank you, ma'am.

Mr. Curbelo, you are recognized.

Mr. Curbelo. Thank you, Mr. Chairman, for allowing us the opportunity of this hearing, and I thank all of the witnesses for their testimony today.

Ms. Lough, 70 percent of taxes collected are payroll taxes. Does that sound right?

Ms. Lough. Yes, 70 percent are payroll taxes, but that includes individual income tax as well, that 70 percent.

Mr. Curbelo. Well, given that significant number, it seems to me that this should be a compliance priority for the IRS. Does that make sense?

Ms. Lough. Again, it is a compliance priority for the IRS, the payroll income tax. But 70 percent of the tax that is collected -- I just want to make sure I understand your question -- 38 percent is the income tax part of it and 32 percent is the Social Security and Medicare tax part of the 70 percent.

Mr. Curbelo. I understand that, but either way, we are talking about at least around a third of total collections. So my question to you is, what percentage of audits conducted by the IRS are related to payroll taxes?

Ms. Lough. So a large number -- this also includes public and private government, public and private employers. And I have jurisdiction over the public employers, which are about 90,000 government entities. So we do audit. We audit a few hundred per year, but we also provide extensive outreach to these government entities. That can be small towns or large States and cities.

Mr. Curbelo. So do you have empirical evidence that this is, indeed, a compliant group?

Ms. Lough. From the basis of the audits that we have done and our relationships that we have with the State and local governments, my opinion is that this is largely a compliant group. Not that they always meet 100 percent of the requirements, but the reason often is because of the complexity of the rules and lack of understanding of where the employee falls, whether they are covered or they are not, whether they are under a qualified retirement plan. When did they start working? Was there a break in service? It is an exceedingly complex area of the law.

Mr. Curbelo. Well, we have heard many examples over the years of local employers being noncompliant. So I just want to make sure -- and I understand the issue of resources, and I certainly believe that we need to make sure not just the IRS but the entirety of our government is adequately resourced. But it does seem to me like we are leaving a significant amount of money on the table. And I still wonder if there is a focus on enforcing compliance in this area, given that it represents around a third of collections for the IRS.

Ms. Lough. The IRS does have a robust payroll employment tax audit program, whether it is a private or public employer program, commensurate to the amount of resources we have. But for the public employers, one in five employees works for the public employer. So the large portion are private employers. And public employers are largely a very compliant taxpayer base.

Mr. Curbelo. Thank you, Ms. Lough.

Ms. Motza, a question for you. I want to focus on this issue of classification. What role specifically do State Social Security Administrators play to ensure that workers within the State who are covered by Social Security

are properly classified? What oversight role should State Social Security Administrators play in this process?

Ms. Motza. Thank you, Congressman.

Ideally, the State and local governments should contact the State Social Security Administrator to verify what their obligations are under both Federal and State laws. You know, also, the State Administrator should also monitor changes in pension laws in their State to make sure that pension laws that are being changed or have been changed aren't causing confusion and causing somebody who is under a 218 agreement and must continue paying into Social Security to suddenly stop and join a pension plan.

So, as far as classification, it is just a matter of advising them that, if they have a 218 agreement, certain positions are covered under Social Security and others are optionally excluded, or whatever the case may be.

Mr. Curbelo. And quickly, do you think that SSA and the IRS can do more to support States in getting this classification issue right?

Ms. Motza. Yeah. I think, again, it is back to our bugaboo, 1987. If we could communicate more openly and directly upfront, I think it would make it easier on all of us and certainly would save taxpayers money, because everybody that we are dealing with is funded by some form of tax.

Mr. Curbelo. Thank you very much.

Chairman Johnson. The time of the gentleman has expired.

Mr. Reichert, do you care to question?

Mr. Reichert. I do, Mr. Chairman.

Chairman Johnson. You are recognized.

Mr. Reichert. Thank you. I thank Chairman Johnson and Chairman Buchanan for allowing me to make a brief appearance today at your hearing. I am not on either committee, but I am on the Ways and Means Committee, and I chair the Trade Subcommittee, so I appreciate this opportunity. Thank you both.

I want to follow up with a line of questioning that Ms. DelBene was pursuing. As we have heard today, State and local government employees may

participate in Social Security through voluntary coverage agreements. However, no such option exists for members of Tribal Councils. And I know that has been discussed briefly.

I understand, in 2006, the SSA issued a policy ruling clarifying that Tribal Council members cannot receive Social Security coverage because of a 1959 IRS ruling which states that service performed by Tribal Council members do not constitute employment for FICA purposes. While the SSA says that this clarification did not represent a policy change, the effect was that Tribal Council members could no longer contribute to Social Security or have their earnings count toward any future benefits.

And the real question I have, as you might guess, Ms. LaCanfora -- close enough? -- why did it take SSA over 45 years to provide clarification on this issue? So, from 2006 to 1959, what took so long? What was happening in the meantime?

Ms. LaCanfora. We periodically put out clarification when questions arise. My understanding is that Tribal Council leaders were not paid by Tribal Governments until the eighties. And we really didn't receive a lot of questions on the issue. It was only when questions began to come into the Social Security Administration that it was clear that we needed to clarify what was always our longstanding policy.

Mr. Reichert. You don't do systematic reviews of policy or anything that may be controversial or disconnected within the organization?

Ms. LaCanfora. We do. But, again --

Mr. Reichert. Audits?

Ms. LaCanfora. -- we generally clarify issues when questions arise. And in this case, around 2006 was when it became very clear to us that clarification was necessary on that particular issue.

Mr. Reichert. So now we have a problem. You have identified a problem. How do you think this problem should be addressed?

Ms. LaCanfora. As I mentioned in response to the earlier question, we would certainly be pleased to support you with any technical assistance on the legislation that you proposed.

Mr. Reichert. Okay. So I would guess that you would agree this is an unfair policy that has been in existence for these past number of years?

Ms. LaCanfora. We don't have a position on the policy itself.

Mr. Reichert. But you would be happy to help us correct it.

Ms. LaCanfora. Absolutely.

Mr. Reichert. Whatever the problem is.

Okay. I think that the situation has created an unfair environment for our Tribal friends. And I have heard from Tribal Council members, from the Muckleshoot Tribe in Washington State and others across the country. They want to participate in Social Security, and I think we need to make that happen. I have introduced a bill to make this possible. So I will have my staff reach out to you and look forward to your cooperation in resolving this issue.

Ms. LaCanfora. Thank you.

Mr. Reichert. Thank you. I yield back.

Chairman Johnson. Thank you.

I appreciate the testimony of everyone. As we have heard today, Social Security and the IRS don't have their act together when it comes to State and local workers. Social Security doesn't know whether State and local governments are reporting the right amount of wages, and Social Security counts earnings toward future benefits, even if taxes weren't paid. The IRS doesn't know whether an employee, employer, or worker is paying the right amount of payroll tax.

When errors go unnoticed for years, like in Missouri, this has a real effect on workers' retirement security and on the Trust Funds. Social Security, the IRS, and States must accept the responsibility for the roles they play in making this process work the way it should. I think you all would agree: Americans deserve nothing less.

I want to thank our witnesses for your testimonies. Thank you so much. And thank all the Members for being here.

With that, the Subcommittee stands adjourned.

[Whereupon, at 11:33 p.m., the subcommittees were adjourned.]

MEMBER QUESTIONS FOR THE RECORD

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July 13, 2017

Marianna LaCanfora
Acting Deputy Commissioner
Office of Retirement and Disability Policy
6401 Security Boulevard
Baltimore, MD 21235

Dear Ms. LaCanfora:

Thank you for your testimony before the Committee on Ways and Means at the June 29, 2017 Social Security and Oversight Subcommittees' joint hearing entitled, "Complexities and Challenges of Social Security Coverage and Payroll Tax Compliance for State and Local Governments." In order to complete our hearing record, we would appreciate your responses to the following questions:

1. If a state or local government fails to pay payroll taxes for an employee who is supposed to be covered under Social Security, only the last three years of unpaid taxes must be repaid due to the statute of limitations. Is there a similar statute of limitations for the Social Security Administration (SSA) to credit earnings to a worker's account? Will the SSA credit earnings for years when taxes were not paid?
2. Since the amount of revenue that goes to the Social Security Trust Funds is based on covered earnings instead of taxes paid, what happens if covered earnings are higher than payroll taxes received and there is a gap between the amount of payroll taxes received and the amount of revenue going to the Trust Funds? Are general revenues being used to fill that gap?
3. What data sources are used to arrive at the earnings amount used to calculate the amount of revenue that goes to the Social Security Trust Funds? If an individual goes through the process of getting his/her earnings record corrected, are the corrected earnings always factored into this calculation?
4. If an employer reports an error to the SSA, what is the process for updating the affected employees' earnings records with Social Security? Does the SSA provide the corrected information to the IRS?

5. If an individual finds an error with his/her earnings record when reviewing his/her Social Security statement or claiming benefits, what is the process for correcting the error? Does the individual have to prove that he/she paid Social Security taxes or will the SSA accept other types of evidence? What types of evidence are acceptable?
6. When a state or local government mischaracterizes an employee as non-covered when they actually are, how would that impact the employee when he/she begins to apply for benefits? Is it possible that the person may receive a lower benefit amount than he/she is entitled to or appear to not be eligible for benefits at all?
7. If the SSA identifies an issue with a public employer, does the SSA share this information with the Internal Revenue Service and the State Social Security Administrator? Under what circumstances would the SSA share this information?
8. How does the SSA plan to use and maintain the Section 218 database? When will the database be ready for use?
9. Following the addition of Section 218 to the Social Security Act, the SSA required states to create the role of State Social Security Administrator, which states may not have done otherwise. What was the rationale for requiring the establishment of a state-funded position? Do you view the responsibilities of the State Administrator as strictly state functions, or in absence of such a person, would additional work by the SSA be required?

Question from Rep. Jim Renacci

1. As you know, a worker's salary isn't always the same as the earnings Social Security uses. If the worker's position isn't covered for Social Security, then earnings from that job will not be counted toward future benefits. For example in my state of Ohio, less than 5% of state and local government employees are covered by Social Security. If an individual's earnings are covered, Social Security earnings may be lower than her salary because some things, like the health insurance premiums, are exempt from Social Security taxes. Since the amount of Social Security earnings is used to calculate benefits, this is an important number to get right. Does Social Security have a way to know whether a worker should be covered by Social Security and to check whether the amount of Social Security earnings reported on the W-2 is correct? What information would you need that you don't have today?

We would appreciate your responses to these questions by **July 27, 2017**. Please send your response to the attention of Amy Shuart, Staff Director, Subcommittee on Social Security, and Meinan Goto, Professional Staff, Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, 2018 Rayburn House Office Building, Washington, DC 20515. In addition to a hard copy, please submit an electronic copy of your response in Microsoft Word format to Liz.Navin@mail.house.gov and MM.Russell@mail.house.gov.

Thank you for taking the time to answer these questions for the record. If you have any questions concerning this request, you may reach Amy or Meinan at (202) 225-9263.

Sincerely,



Sam Johnson
Chairman
Subcommittee on Social Security



Vern Buchanan
Chairman
Subcommittee on Oversight



SOCIAL SECURITY

Office of Retirement and Disability Policy

September 26, 2017

The Honorable Sam Johnson
Chairman, Subcommittee on Social Security
Committee on Ways and Means
United States House of Representatives
Washington, DC 20515

The Honorable Vern Buchanan
Chairman, Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives
Washington, DC 20515

Dear Chairman Johnson and Chairman Buchanan:

Thank you for the opportunity to provide information to complete the record from the June 29, 2017 hearing entitled "Complexities and Challenges of Social Security Coverage and Payroll Compliance for State and Local Governments." Enclosed please find our answers to your and Congressman Renacci's questions.

I hope this information is helpful. When I appeared before you in June it was in my capacity as the Acting Deputy Commissioner for the Office of Retirement and Disability Policy. I am sending the enclosed information to you on that office's behalf. However, I have since changed positions, and look forward to working with you and your staff in my current role as the Deputy Commissioner for Human Resources. If you or your staff have any further questions, please do not hesitate to contact me or Royce Min, our Acting Deputy Commissioner for Legislation and Congressional Affairs, at (202) 358-6030.

Sincerely,


Marianna LaCanfora
Deputy Commissioner for
Human Resources

Enclosure

- 1. If a state or local government fails to pay payroll taxes for an employee who is supposed to be covered under Social Security, only the last three years of unpaid taxes must be repaid due to the statute of limitations. Is there a similar statute of limitations for the Social Security Administration (SSA) to credit earnings to a worker's account?**

In general, the Social Security Act (“Act”) allows us to correct our earnings records within three years, three months, and 15 days of the year in which the wages were paid or self-employment income was derived.¹ After this time limit has expired, we are generally prohibited from changing our earnings records, except in certain situations. For example, the Act allows us to correct our earnings records after that period has expired when new and more accurate wage information becomes available.² For example, we can add earnings to a person’s earnings record after the period has expired if he or she provides proof such as a corrected wage and tax statement (Form W-2c).³ We can make such corrections at any time.

Will the SSA credit earnings for years when taxes were not paid?

If a state or local government were to fail to withhold payroll taxes for an employee whose wages are covered under the Act, we can add those wages to the person’s earnings record, provided again that SSA has proof that wages were paid (for example, a Form W-2c with the wage amount displayed in the Social Security wages and tips boxes). The Act ties our earnings records to the amounts of wages paid, and not to the taxes paid under the Federal Insurance Contributions Act (FICA) nor the Internal Revenue Service’s (IRS) ability to collect those taxes.

Our understanding is that, in general, the IRS is limited in recovering the unpaid payroll taxes in such scenarios to the three prior years. Therefore, depending on how long ago the error occurred, we may be able to correct our earnings record, but the IRS could be unable to recover the unpaid taxes.

- 2. Since the amount of revenue that goes to the Social Security Trust Funds is based on covered earnings instead of taxes paid, what happens if covered earnings are higher than payroll taxes received and there is a gap between the amount of payroll taxes received and the amount of revenue going to the Trust Funds? Are general revenues being used to fill that gap?**

The Department of the Treasury (“Treasury”) credits the Social Security Trust Funds based on the total amount of the FICA and Self Employment Contributions Act (SECA) tax *liabilities*, rather than the amount of these taxes it actually *receives*. Treasury determines this amount by multiplying the total taxable wages and self-employment income for a year by the Old-Age, Survivors, and Disability Insurance (OASDI) portion of the FICA/SECA tax rate, adjusted to account for the OASDI wage base. Treasury

¹ See Social Security Act § 205(c)(1)(B), (c)(4) [42 U.S.C. § 405(c)(1)(b), (c)(4)].

² See Social Security Act § 205(c)(5) [42 U.S.C. § 405(c)(5)].

³ See Social Security Act § 205(c)(5)(F), (H) [42 U.S.C. § 405(c)(5)(F),(H)].

credits the Trust Funds daily based on estimates, and every quarter reconciles the credited amounts for all prior years based on the latest wages and self-employment income data.

Prior to the enactment of the Social Security Act Amendments of 1950, Treasury credited Social Security's Trust Fund based on the amount of taxes received.⁴ However, that system was expensive for Treasury to administer. Furthermore, it could have caused a shortfall in the Trust Fund—SSA's monthly benefit payments are predictable and regular, whereas tax receipts fluctuate over time. Congress recognized and addressed these issues by creating the current process with the enactment of the Social Security Act Amendments of 1950.

Under the current system, Treasury uses general funds to cover the difference between tax liabilities and receipts. We would defer to Treasury regarding the scope of the difference between liabilities and receipts over time.

3. What data sources are used to arrive at the earnings amount used to calculate the amount of revenue that goes to the Social Security Trust Funds?

SSA's role in the process of crediting the Trust Funds is to "certify" to the Treasury the total amount of covered wages and self-employment income subject to Social Security tax. We determine the total amount of wages for a year by using the greater of the total wages on Forms W-2 (provided by employers) and the total wages on employers' quarterly tax returns (Form 941), which is provided by the IRS. We determine the total amount of taxable self-employment income using data from individual taxpayers' Schedules SE (Form 1040), which is again provided by the IRS. As mentioned in response to question 2 above, Treasury applies the applicable tax rates to this amount to determine the amount it should credit to the Trust Funds.

If an individual goes through the process of getting his/her earnings record corrected, are the corrected earnings always factored into this calculation?

We always adjust the wage totals to reflect corrected wages (e.g., any wage corrections made as a result of processing Forms W-2c). We consider any corrections when determining the total amount of wages and self-employment income to certify to the Treasury.

4. If an employer reports an error to the SSA, what is the process for updating the affected employees' earnings records with Social Security?

To correct an error in an employee's wages filed on a Form W-2, an employer would most commonly file a corrected wage and tax statement (Form W-2c) with us. Depending on the nature of the error and when it occurred, we may be prohibited from correcting it, as I noted in response to question 1 above.

⁴ Pub. L. No. 81-734, § 109(a).

Does the SSA provide the corrected information to the IRS?

Yes. When we process Forms W-2c, we share all of the corrected earnings information with the IRS.

5. If an individual finds an error with his/her earnings record when reviewing his/her Social Security statement or claiming benefits, what is the process for correcting the error? What types of evidence are acceptable?

When someone applies for retirement or disability insurance benefits, we review their earnings record with them. During this review, we make sure the individual's earnings record is accurate and identify any errors such as incorrect amounts or unexplainable gaps.

If an individual finds an error on his or her earnings record, he or she must provide evidence of the correct amount of the earnings before we can update our records. An individual must generally submit what we consider to be primary evidence (e.g., a Form W-2, a Form W-2c, or an end-of-year pay stub) or two pieces of secondary evidence (e.g. union records or records from State unemployment insurance agencies). When we change our earnings records, we also share the earnings correction determination with the IRS for their purposes.

Does the individual have to prove that he/she paid Social Security taxes or will the SSA accept other types of evidence?

The Act does not require that we obtain proof that an individual has actually paid FICA taxes before we add the earnings to a person's record. A failure to pay FICA has no impact on our ability to correct the earnings record under current law. We do, however, share updated wage information with the IRS so they can recover any unpaid taxes, to the extent permitted by law. We ensure accurate earnings records, and the IRS is responsible for ensuring accurate payment of FICA.

6. When a state or local government mischaracterizes an employee as non-covered when they actually are, how would that impact the employee when he/she begins to apply for benefits? Is it possible that the person may receive a lower benefit amount than he/she is entitled to or appear to not be eligible for benefits at all?

Eligibility for OASDI benefits, and the amount of those benefits, depends on an individual's covered wages and self-employment income. If a State or local government were to mischaracterize an employee's earnings as being non-covered, it could cause the person to either be ineligible for benefits or receive a lower benefit amount. However, as stated in response to question 5 above, we review an individual's earnings record with them when they apply for retirement or disability insurance benefits, to make sure their earnings record is accurate.

As I noted in response to question 1 above, if someone recognizes that his or her covered

wages have been mischaracterized as non-covered wages, we can correct the affected person's record, provided that we receive proof of the person's covered wages. As I noted in response to question 5, our ability to correct the affected person's record does not depend on the payment of FICA taxes.

7. If the SSA identifies an issue with a public employer, does the SSA share this information with the Internal Revenue Service and the State Social Security Administrator? Under what circumstances would the SSA share this information?

Sometimes a public employer may mischaracterize a group of employees as being covered by Social Security, despite the State's Section 218 Agreement and the Act not supporting that determination. We most often hear of such issues by way of a State's Social Security Administrator or the IRS. They may have discovered the issue through State or IRS compliance efforts. It is rare for SSA to discover this information independently.

Each Section 218 coverage issue is different, and the resolution depends on the case's facts and applicable laws. Our first priority in these situations is to work with the employer and the Administrator to resolve the issue. This can entail, for example, executing a modification to the Section 218 Agreement to provide prospective coverage for the employee group and retroactive coverage for wages for which the group had erroneously paid FICA taxes. We share modifications with the IRS, but we otherwise have no requirement or formal process for notifying the IRS when such an issue comes to our attention.

As I noted in response to question 4 above, we do share information with the IRS whenever we make an earnings correction determination. When a public employer files a Form W-2c with us, we process it, update our records as appropriate, and share the earnings correction information with the IRS.

Our ability to disclose information to State Social Security Administrators is more limited. We disclose certain tax return and non-tax return information to the State Social Security Administrators under the terms and conditions of our Section 218 Agreement with the State. However, we may only disclose tax return information to a State Social Security Administrator that was originally provided to the agency by the State Social Security Administrator.

8. How does the SSA plan to use and maintain the Section 218 database? When will the database be ready for use?

The Section 218 Agreement database houses Section 218 Agreements, modifications, and their related documents. The database allows us to search for entities and positions among a State's Section 218 Agreement and its modifications. This allows us to complete a portion of the research needed for State-requested coverage determinations with greater ease.

The database is currently operational and in use by our employees, although we continue to look for ways to enhance it. We have scanned approximately 90% of Section 218 Agreements, modifications, and their related documents. We are working to scan the remainder, ensuring that all documents are legible and organized correctly. We expect that we will have all documents scanned into the database by the end of 2018. We will maintain the database, adding new modifications and supporting documents as the modifications are executed.

9. Following the addition of Section 218 to the Social Security Act, the SSA required states to create the role of State Social Security Administrator, which states may not have done otherwise. What was the rationale for requiring the establishment of a state-funded position?

It is important that public employers get their employees' coverage status right. When a State voluntarily enters into a Section 218 Agreement with us, it agrees to perform certain duties (listed below) in order to implement the Agreement's corresponding coverage. Because of this, we believe it is critical that the official who is executing 218-related matters acts on behalf of and with the full authority of the State. This is why our regulations require the States to designate an Administrator if they enter into a Section 218 Agreement with us.

Do you view the responsibilities of the State Administrator as strictly state functions, or in absence of such a person, would additional work by the SSA be required?

A State Social Security Administrator's basic responsibilities are to:

- Permanently maintain physical custody of the Section 218 Agreement and associated documents;
- Determine which State and political subdivision employees' positions are covered by approved Section 218 Agreements and modifications;
- Work with employers to guarantee proper Social Security and Medicare withholding and reporting;
- Take appropriate steps with respect to the execution of modifications to the original agreement to include additional coverage groups, correct errors in coverage, or identify additional political subdivisions that join a covered retirement system;
- Conduct referenda on the coverage of services of individuals in positions under a retirement system;
- Identify new, inactive, merged or dissolved political subdivisions, and take the appropriate coverage related action;
- Provide SSA with notice and evidence of the legal dissolution of covered State or political subdivision entities;
- Provide guidance to government employers on issues related to Section 218 coverage;

- Work with SSA and the IRS to address coverage and taxation questions related to the Agreement and any modifications; and
- Serve as an intermediary for federal, State and local agencies, and educate public employers on coverage and benefit issues.

While we currently duplicate some of these responsibilities out of administrative necessity, such as document retention, we cannot properly perform others because we have no authority to act as an agent for the State itself or intervene in the State's process of deciding what positions it wants to cover. The Act, rather, requires us to agree to whatever coverage terms the State requests. Therefore each State must remain responsible for many of these functions with respect to its employees and its compliance with the Act, the Internal Revenue Code of 1986, and other applicable laws. In the absence of an Administrator, other State officials would have to perform such functions. Requiring a State Administrator ensures that the person performing these functions has existing familiarity with the complexity of coverage.

Question from Rep. Jim Renacci

- 1. As you know, a worker's salary isn't always the same as the earnings Social Security uses. If the worker's position isn't covered for Social Security, then earnings from that job will not be counted toward future benefits. For example in my state of Ohio, less than 5% of state and local government employees are covered by Social Security. If an individual's earnings are covered, Social Security earnings may be lower than her salary because some things, like the health insurance premiums, are exempt from Social Security taxes. Since the amount of Social Security earnings is used to calculate benefits, this is an important number to get right. Does Social Security have a way to know whether a worker should be covered by Social Security and to check whether the amount of Social Security earnings reported on the W-2 is correct?**

The Internal Revenue Code of 1986 generally requires each employer to determine whether its employees' wages should be covered, withhold and remit payroll taxes, accurately complete a Form W-2 for each employee, and file a copy of that form with us. The IRS ensures compliance with these requirements by conducting periodic examinations and audits of employers, to the extent its resources allow.

In the course of processing Forms W-2, we do certain checks to make sure that we are crediting the wages to the right person's record and that the total earnings reported by an employer on its Forms W-2 are consistent with the earnings reported on its quarterly tax return (Form 941). Otherwise, we do not have a way to know whether an employer has reported its employees' wages accurately. For this reason, employers are important partners in this process, as they are responsible for identifying their employees' coverage status and withholding and paying the appropriate amount of FICA.

What information would you need that you don't have today?

Because the IRS has oversight in this area, we would defer to them.

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MINORITY CHIEF OF STAFF

July 13, 2017

Sunita B. Lough
Commissioner
Tax-Exempt and Government Entities Division
1111 Constitution Avenue NW
Washington, DC 20224

Dear Ms. Lough:

Thank you for your testimony before the Committee on Ways and Means at the June 29, 2017 Social Security and Oversight Subcommittees' joint hearing entitled, "Complexities and Challenges of Social Security Coverage and Payroll Tax Compliance for State and Local Governments." In order to complete our hearing record, we would appreciate your responses to the following questions:

1. Sometimes payroll tax withholding problems can go back 10 or more years, what is the statute of limitations for correcting payroll tax withholding errors? How does the current statute of limitations affect the ability of the Internal Revenue Service (IRS) to recover lost payroll taxes?
2. Do the issues with Social Security payroll tax noncompliance also apply when it comes to Medicare payroll taxes?
3. In the event that an employer inadvertently withholds too little in payroll taxes, yet reports the same amount on both forms when reporting to both the Social Security Administration (SSA) and the IRS, would the reconciliation process flag this? If not, what other ways can the IRS identify this error?
4. If an employer's quarterly tax return has a zero for taxable Social Security wages, does this automatically generate a flag for follow up? If not, under what circumstances would there be a flag? Are obvious anomalies flagged for review by the IRS, such as everyone in a firm having a salary of \$0 or having the same salary?
5. How do the majority of compliance issues come to light? Do state and local employers self-identify the issue or are they typically found through IRS audits?

6. What is the percentage of payroll tax noncompliance for all employers? What is this percentage for state and local government employers?
7. State and local governments regularly make changes to their qualifying retirement plans. How does the IRS make sure that a state/local government's pension plan continues to meet the requirements for being a FICA-replacement plan? How is the assessment made and how often are plans reevaluated? Does this assessment take into account the ultimate benefit amount paid to the pension recipient or just the amount contributed by the employer or employee?

Question from Rep. Tom Rice

1. Ms. Lough, you mentioned that 26 U.S.C. § 6103 contains an exception that would allow the IRS to share information with the Social Security Administration. Additionally, you stated that the IRS does share information "when it becomes necessary...with regards to specific public employers." Under what specific situation does the IRS share information with the SSA? When the IRS does share information with the SSA, what data elements are shared?

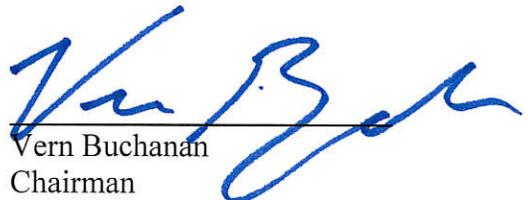
We would appreciate your responses to these questions by **July 27, 2017**. Please send your response to the attention of Amy Shuart, Staff Director, Subcommittee on Social Security, and Meinan Goto, Professional Staff, Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, 2018 Rayburn House Office Building, Washington, DC 20515. In addition to a hard copy, please submit an electronic copy of your response in Microsoft Word format to Liz.Navin@mail.house.gov and MM.Russell@mail.house.gov.

Thank you for taking the time to answer these questions for the record. If you have any questions concerning this request, you may reach Amy or Meinan at (202) 225-9263.

Sincerely,



Sam Johnson
Chairman
Subcommittee on Social Security



Vern Buchanan
Chairman
Subcommittee on Oversight

Questions for the Record

Complexities and Challenges of Social Security Coverage and Payroll Compliance for State and Local Governments

House Ways and Means Committee Subcommittee on Social Security and Subcommittee on Oversight

June 29, 2017

1. Sometimes payroll tax withholding problems can go back 10 or more years, what is the statute of limitations for correcting payroll tax withholding errors? How does the current statute of limitations affect the ability of the Internal Revenue Service (IRS) to recover lost payroll taxes?

The normal period of limitations for assessment of tax with respect to a tax return expires three years after the return is filed or due, whichever is later. See 26 U.S.C. § 6501(a) and (b)(1). The date that the period of limitations expires is also referred to as the “statute date.”

For certain employment tax returns, the statute date is based on a “deemed filing date.” Employment tax returns filed quarterly, such as Form 941, *Employer’s QUARTERLY Federal Tax Return*, must generally be filed by the last day of the month following the end of the quarter (for the quarter ending 3/31/17, the return would be due by 4/30/17). For the purpose of determining the period of limitations for assessments, a quarterly return filed for any of the quarters of the calendar year has a deemed filing date of April 15 of the succeeding calendar year, per 26 U.S.C. § 6501(b)(2). For example, the deemed filing date for Forms 941 for the quarters ending 3/31/17, 6/30/17, 9/30/17, and 12/31/17, would be 4/15/18. The deemed filing date applies to withholding of tax on non-resident aliens and foreign corporations (26 U.S.C. §§ 1441-1464), Social Security tax and Medicare tax (Federal Insurance Contributions Act, 26 U.S.C. §§ 3101-3128), and federal income tax withholding (Collection of Income Tax at Source on Wages, 26 U.S.C. §§ 3401-3406).

The “deemed filing date” rule generally applies if a payroll tax return for any of the quarters of the calendar year is filed on or before April 15 of the succeeding calendar year. When the “deemed filing date” rule applies, the period of limitations will expire 3 years after the deemed filing date. Any return filed after April 15 of the succeeding year has a statute date three years from the date the return is actually filed. See 26 C.F.R. § 301.6501(b)-1(b).

Form 940, *Employer’s Annual Federal Unemployment (FUTA) Tax Return*, is due by January 31 following the end of the calendar year. Form 940 does not have a deemed filing date. Thus, the statute date for the Form 940 is three years from the date the return is filed or due, whichever is later. Because remuneration for service in the employ of a state or local government is generally excepted from FUTA tax under 26 U.S.C.

§ 3306(c)(7), FUTA tax liability does not generally arise in state and local government audits.

There are certain exceptions to the general statute of limitations rules. A taxpayer may voluntarily agree with the IRS to extend the statute of limitations for an open period, which is often done during the course of an audit. For employment tax returns, taxpayers execute Form SS-10, *Consent to Extend the Time to Assess Employment Taxes*, to extend the statutory period for assessment. Under 26 U.S.C. § 6501(c)(3), tax may be assessed at any time if no return was filed by the taxpayer. Additionally, there is no time limit on assessment of tax when a taxpayer has filed a false or fraudulent return with the intent of evading tax. See 26 U.S.C. § 6501(c)(1) and (2).

In summary, the IRS is unable to assess additional employment taxes three years beyond the deemed filing date or actual filing date (whichever is later), except in situations where (1) the taxpayer agrees to extend the applicable limitations period, (2) the required return(s) have not been filed, or (3) clear and convincing evidence exists that the taxpayer has filed a false or fraudulent return with the intent of evading tax.

2. Do the issues with Social Security payroll tax noncompliance also apply when it comes to Medicare payroll taxes?

It depends on the situation, but issues with Social Security payroll tax noncompliance do not always apply when it comes to Medicare payroll taxes. Unlike with Social Security taxes, almost all public employees are subject to Medicare tax, even those in a public retirement system. In 1986, Social Security and Medicare coverage for state and local government employees became subject to different rules. Prior to 1986, the only way for public employees to be covered for Medicare was under Section 218 Agreements. In 1986, Congress mandated that almost all public employees hired after March 31, 1986 must be covered for Medicare and pay Medicare tax regardless of their membership in a public retirement system. A limited exception (the continuing employment exception) is provided to exempt from Medicare only certain state and local government employees who have been in continuous employment with the same public employer since 1986 and who are not covered under a Section 218 Agreement.

For both public and private employers, a decision to exclude a particular payment from an employee's wages based on applicable law would typically result in potential noncompliance with respect to both Social Security and Medicare payroll taxes. For example, if an employer incorrectly determines that a payment to an employee is excludable from wages as a non-taxable fringe benefit, such determination would result in potential noncompliance with respect to both Social Security taxes (unless the Social Security tax wage base had already been reached with respect to wages paid to that individual) and basic Medicare payroll taxes (which are not subject to a wage base limit).

3. In the event that an employer inadvertently withholds too little in payroll taxes, yet reports the same amount on both forms when reporting to both the Social Security Administration (SSA) and the IRS, would the reconciliation process flag this? If not, what other ways can the IRS identify this error?

Generally, the reconciliation process will not flag this situation because that process is looking for discrepancies between the amounts reported to the SSA on Form W-3, *Transmittal of Wage and Tax Statements*, and the amounts reported to IRS on Form 941. In this example, since the amounts are the same, there are no discrepancies to reconcile.

The way to identify the under-withholding is inspection of the underlying payroll records for individuals through the audit process. The IRS uses various data elements in filed returns to evaluate potential for compliance action. For example, the IRS reviews ratios of social security or Medicare wages to total wages.

4. If an employer's quarterly tax return has a zero for taxable Social Security wages, does this automatically generate a flag for follow up? If not, under what circumstances would there be a flag? Are obvious anomalies flagged for review by the IRS, such as everyone in a firm having a salary of \$0 or having the same salary?

For government employers, this situation of zero Social Security wages will not automatically generate a flag absent a discrepancy with the annual Form W-3 and Form W-2, *Wage and Tax Statement*, filings because a government employer and its employees are not necessarily subject to Social Security tax. For example, if a state or local government entity did not have a Section 218 Agreement and did have a FICA replacement plan for all of its employees, then Social Security wages for all of those employees would be zero. However, the employer would still be expected to report Medicare and income taxable wages, and if it did not, the payroll returns of that employer could be selected for audit.

This situation of zero Social Security wages is of the type noted during routine classification of returns for audit. During classification of returns for audit, the IRS would check whether the taxpayer has a Section 218 agreement and review it for the coverage provisions. If the employer appeared not to be in compliance with those provisions, then those tax returns could be selected for audit.

Also during the classification process, large, unusual, or questionable items on Form 941 or W-2, such as the same compensation for every employee, could lead to audit selection.

The IRS would not be able to flag identical compensation by review of a Form 941, which reports compensation only in the aggregate.

5. How do the majority of compliance issues come to light? Do state and local employers self-identify the issue or are they typically found through IRS audits?

IRS receives a large volume of Forms 941-X, *Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund*, which is a method by which employers self-identify and correct compliance issues. Other compliance issues come to light through the audit process, which may result, for example, from a referral made by an employee, an unrelated taxpayer, or a state or local entity claiming there is an area of non-compliance that needs to be reviewed; classification filters; or projects on specific types of employment tax issues. See the response for question 6 below for information on IRS Federal, State & Local (FSL) audit activity rates.

6. What is the percentage of payroll tax noncompliance for all employers? What is this percentage for state and local government employers?

For both public and private employers, FICA and unemployment tax make up about 3 percent of the gross tax gap, according to the most recent IRS study of the tax gap, which covers taxable years 2008 through 2010. The gross tax gap is the sum of the estimated non-filing tax gap, underreporting tax gap, and underpayment tax gap. The data are not compiled at a level of detail distinguishing between public and private employers. For more information on the tax gap, see <https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>.

The IRS audited approximately 0.6 percent of all returns (including income tax, estate and gift tax, employment tax, and excise tax returns) filed in calendar year 2015. IRS Pub. 55-B, *Data Book* (2016) at pg. 21, available at <https://www.irs.gov/pub/irs-soi/16datbk.pdf>. Each year, the FSL function selects for audit a few hundred from tens of thousands of public employers. In FY 2016, of 362 audits of public employers, FSL proposed adjustments to taxable wages in 254.

7. State and local governments regularly make changes to their qualifying retirement plans. How does the IRS make sure that a state/local government's pension plan continues to meet the requirements for being a FICA-replacement plan? How is the assessment made and how often are plans reevaluated? Does this assessment take into account the ultimate benefit amount paid to the pension recipient or just the amount contributed by the employer or employee?

The IRS may examine whether a plan met the requirements for a FICA replacement plan through an audit, by inspecting the plan and evaluating it in terms of the requirements. FICA replacement plan requirements do not affect whether the retirement plan is a "qualified" plan per 26 U.S.C. § 401(a). A retirement system that qualifies as an alternative to Social Security provides for a retirement benefit to the employee that is comparable to the benefit provided by the Old-Age portion of the Old-Age, Survivor and

Disability Insurance program of Social Security. For mandatory coverage purposes, the employee may be a member of any type of retirement plan, including a nonqualified deferred compensation plan such as a section 457 plan, as long as the plan provides the minimum level of benefits required for a FICA replacement plan. These requirements are discussed in 26 C.F.R. § 31.3121(b)(7)-2(e) and in Revenue Procedure 91-40.

The IRS's assessment is based upon the type of retirement plan:

- A defined contribution plan provides an individual account for each participant and provides benefits based solely on the amount contributed.
- A defined benefit plan determines benefits on the basis of a formula, generally based on age, years of service, and salary level.

Publication 963, *Federal-State Reference Guide*, Chapter 6 provides detailed explanations of the FICA replacement plan requirements with regard to the type of retirement system a state or local government may maintain.

Question from Rep. Tom Rice

1. Ms. Lough, you mentioned that 26 U.S.C. § 6103 contains an exception that would allow the IRS to share information with the Social Security Administration. Additionally, you stated that the IRS does share information “when it becomes necessary...with regards to specific public employers.” Under what specific situation does the IRS share information with the SSA? When the IRS does share information with the SSA, what data elements are shared?

26 U.S.C. § 6103(l)(1) allows the IRS, upon written request, to disclose to the SSA tax returns and return information relating to taxes imposed under chapter 2 (self-employment income), chapter 21 (FICA), and chapter 24 (income tax withholding), to administer the Social Security Act; and chapter 22 (Railroad Retirement Tax Act), to administer the Railroad Retirement Act. The IRS may also disclose to the SSA information from Form 8955-SSA, *Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits*, pertaining to private retirement plans. Additional provisions allow disclosure for other SSA programs, including § 6103(h)(5) (address and citizenship status for purposes of foreign withholding tax), § 6103(l)(5) (information returns and epidemiological research), § 6103(l)(12)(A) (verification of spouse of Medicare beneficiary), § 6103(l)(20) (Medicare Part B premium subsidy adjustment and Part D base beneficiary premium increase), and § 6103(m)(7) (address of person entitled to receive an SSA retirement account statement).

The IRS may ask the SSA about the FICA coverage of particular public employees. A 2002 Memorandum of Understanding between the IRS and the SSA for state and local government compliance issues says that the SSA is responsible for determining the coverage status of state and local government employees covered under a state's Section 218 agreement (including modifications).

In the course of a specific examination, a public employer may direct the IRS to share information with the SSA, the State Social Security Administrator, or any other party. Form 8821, *Tax Information Authorization*, is available for this purpose. On this form,

the public employer may designate the type of tax, tax form, year or period, and specific tax matter for information sharing.

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MINORITY CHIEF OF STAFF

July 13, 2017

Maryann Motza, Ph.D.
Legislative Committee Chair
National Conference of State Social Security Administrators
15002 East Walsh Drive
Aurora, CO 80012

Dear Dr. Motza:

Thank you for your testimony before the Committee on Ways and Means at the June 29, 2017 Social Security and Oversight Subcommittees' joint hearing entitled, "Complexities and Challenges of Social Security Coverage and Payroll Tax Compliance for State and Local Governments." In order to complete our hearing record, we would appreciate your responses to the following questions:

Question from Rep. Tom Rice

1. In your testimony you wrote that "[s]tate Administrators can help all levels of government avoid the negative financial, media, and political consequences that occur when federal and state laws are not properly complied with by state and local governments and public pension systems." Please provide a description of the types of tax compliance issues that additional information provided to State Social Security Administrators can help resolve. Please include:
 1. A description of the issue.
 2. The specific information that would be shared (for example, would Administrators only need the name of the taxpayer and a brief description of the issue or would additional information be needed).
 3. How would the information assist federal agencies in resolving tax compliance issues.

Question from Rep. Jim Renacci

1. In your testimony you state that no Section 218 Agreements or even modifications can be entered into by a local government without the authorization from state

governments and that in recent years the Social Security Administration and the IRS have been largely unavailable in assisting states in education efforts. Can you go further into detail about this lack of coordination and what more could be done in order to improve the education efforts for local employers and employees?

We would appreciate your responses to these questions by **July 27, 2017**. Please send your response to the attention of Amy Shuart, Staff Director, Subcommittee on Social Security, and Meinan Goto, Professional Staff, Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, 2018 Rayburn House Office Building, Washington, DC 20515. In addition to a hard copy, please submit an electronic copy of your response in Microsoft Word format to Liz.Navin@mail.house.gov and MM.Russell@mail.house.gov.

Thank you for taking the time to answer these questions for the record. If you have any questions concerning this request, you may reach Amy or Meinan at (202) 225-9263.

Sincerely,



Sam Johnson
Chairman
Subcommittee on Social Security



Vern Buchanan
Chairman
Subcommittee on Oversight

July 24, 2017

Ms. Amy Stuart
Staff Director
Subcommittee on Social Security

AND

Mr. Meinan Goto
Professional Staff
Subcommittee on Oversight

Committee on Ways and Means
U.S. House of Representatives
2018 Rayburn House Office Building
Washington, DC 20515

RE: Responses to follow-up questions from the June 29, 2017, Committee on Ways and Means, Social Security and Oversight Subcommittees' joint hearing entitled, "Complexities and Challenges of Social Security Coverage and Payroll Tax Compliance for State and Local Governments"

Dear Ms. Stuart and Mr. Goto:

This is in response to the questions posed by Representative Rice and Representative Renacci in the letter from Chairman Johnson and Chairman Buchanan dated July 13, 2017.

Question from Representative Tom Rice:

1. In your testimony you wrote that "[s]tate Administrators can help all levels of government avoid the negative financial, media, and political consequences that occur when federal and state laws are not properly complied with by state and local governments and public pension systems." Please provide a description of the types of tax compliance issues that additional information provided to State Social Security Administrators can help resolve. Please include:
 1. A description of the issue.
 2. The specific information that would be shared (for example, would Administrators only need the name of the taxpayer and a brief description of the issue or would additional information be needed).
 3. How would the information assist federal agencies in resolving tax compliance issues?

Answer:

In 2014, the Internal Revenue Service (IRS)/Federal-State-Local Governments (FSLG) section identified many compliance risk areas that exist nationwide among state and local governments. The list and a description of each risk area are included as an attachment to this letter, but the major categories are:

1. Public School "Teacher" Positions
2. Policeman and Firefighter Positions
3. Section 414(h)(2) employer pick-up issues
4. Qualifying FICA Replacement Plans
5. Retirement Plan Types
6. Government Entity Restructuring
7. Charter Schools
8. Mandatory Medicare Coverage
9. Part-time Positions
10. Student Services

All states have some or all of the above risk areas. If the IRS could directly communicate with the State Administrator in each state about specific compliance issues unique to that state, the IRS' time and other resource expenditures would dramatically decrease. Further, if the IRS could discuss the issues specific to their state, then the State Administrator could focus attention on targeted education and outreach to public employers in their states that are experiencing those risks.

When conducting a compliance check or examination, the IRS should be able to contact the State Administrator prior to reaching out to the individual governmental entity for specific information about the Social Security (and Medicare only) and public pension plan coverage that is applicable to each employee group and positions of that entity. SSA, IRS, and State Attorney General's Office interpretative information held by the State Administrator could be shared as well. By the IRS reviewing and discussing with the State Administrator all of the information contained in the files maintained by the State, the costs to all parties (especially IRS and the individual state or local government) would be significantly reduced. Even when the state or local government employer has historic records, due to staff turnover and lack of training, many of their officials are not familiar with all applicable federal and state law nuances that apply to their individual employees. This is why the State Administrator needs to be involved to aid all parties when such compliance checks and examinations are conducted by the IRS.

Open communication between the IRS and State Administrator prior to the IRS initiating contact with an individual public employer will enable the IRS to know which positions are or are not required to be covered by Social Security (or Medicare only), those who are required to be covered by a combination of Social Security and a pension plan (and which one if the entity has more than one such plan), and those who are members of a FICA replacement plan. Accurate and complete information needs to be shared about individual employees within each governmental entity.

The current payroll or finance officer of a public entity is often merely continuing to do what his or her predecessor did without knowing the reasons. Worse yet, due to budget constraints, most governments must leave positions vacant for a period of time after an employee resigns or retires. In some cases, an employee from the private sector is hired who is unaware of the unique laws that apply to state and local governments and may erroneously begin (or stop)

withholding Federal Insurance Contributions Act (FICA) taxes. Also, state and local governments may erroneously begin (or stop) withholding FICA taxes when state legislative changes are made to public pension laws. The next two paragraphs contain, respectively, an excellent example of how a knowledgeable State Administrator can prospectively address what could become a significant compliance issue and, thereby, assist federal agencies by preventing future coverage and tax problems, followed by an example of what happens when a state has failed to properly support the State Administrator function.

One state had an issue where the state's main retirement system made a change to the police retirement plan. The State Administrator was not the one reviewing proposed legislative changes and the person assigned to monitor state legislation missed the significance of the change. The State Administrator learned of the change in a retirement system newsletter that a new plan was created, and now the police would pay Social Security. The State Administrator immediately called the parties involved and was able to resolve the issue before any new police were hired into the new retirement plan. The new police plan had voted in a Section 218 referendum election not to pay Social Security so it would have resulted in significant errors in Social Security coverage and improper FICA tax payments that could have taken years to resolve and been costly to all police departments that improperly followed the changes to state laws that were contrary to the state's enabling legislation that implemented Section 218 of the U.S. Social Security Act. If the State Administrator had not become aware of the change erroneous payment into Social Security could have occurred for years. In the future, when the IRS conducts a compliance check or examination of a governmental entity in that state, potential non-compliance with federal laws have been avoided thereby assisting federal agencies in prospectively ensuring compliance. This results in a savings of time and resources by the federal government and the governmental entity which, in turn, saves tax revenue that can be used elsewhere.

As the above example shows, one of the responsibilities of the State Administrator's office is to monitor proposed legislation related to public pensions within each of their states. An example of how important the role the State Administrator plays was documented in the Government Accountability Office (GAO) Report Number 10-938 (cited in NCSSSA's original testimony). That GAO report noted that Missouri had not monitored changes in their public school retirement plan, whereby errors in payments were made over decades, resulting in coverage errors in hundreds of school districts.

Improved education and outreach efforts by the states, SSA, and IRS (explained below in my response to Representative Renacci's question) can reduce state and local governments' mistakes like those described above. Unfortunately, current budget limitations in the states and at the SSA and IRS have prevented them from conducting joint education and outreach sessions like those that occurred in the late 1990s' and early 2000's (described in our original written testimony on pages 6-7 as the first Area for Improvement).

Thus, the best approach to address all state and local governments' FICA tax, Social Security and Medicare coverage, and pension system coverage matters would be for the IRS to continually have a dialogue with the State Administrator. That dialogue should include discussing the nature and extent of Social Security, Medicare, and public pension plan coverage that applies to each position of each entity. Further, ideally the State Administrator should monitor state legislative changes to public pension plans and coverage to ensure compliance with applicable federal laws and that State's Section 218 Agreement and enabling legislation. Any valid changes to state pension laws should, in turn, be shared with both SSA

and the IRS by the State Administrator so both the federal and state officials are kept apprised of applicable coverage and tax obligations. The State Administrator is the most knowledgeable resource for the SSA, IRS, all state and local governments (and their legal and financial advisors), and public pension system officials within their state.

To help further respond to subquestion 1 of Representative Rice's follow-up question, I am providing a copy of a *Government Finance Review* article that was published in 2009 entitled: "Common Errors in State and Local Government FICA and Public Retirement System Compliance." That article describes common mistakes that occur related to state and local governments' coverage and FICA taxation. The article can help Congress understand and appreciate how coverage and taxation vary not only among the states, but also among different public employers within each state, and even from employee-to-employee.

My response to this question also includes a copy of a letter sent to U.S. Treasury Department officials on September 9, 2016, when I was the President of the National Conference of State Social Security Administrators (NCSSSA). The letter provides more in-depth information that addresses subquestion 3, including problems associated with Internal Revenue Code (IRC) §6103 vis-à-vis the IRS' inability to communicate directly with State Administrators and the recommended solutions to the problem that have been developed by NCSSSA.

Question from Representative Jim Renacci:

1. In your testimony you state that no Section 218 Agreements or even modifications can be entered into by a local government without the authorization from state governments and that in recent years the Social Security Administration and the IRS have been largely unavailable in assisting states in education efforts. Can you go further into detail about this lack of coordination and what more could be done in order to improve the education efforts for local employers and employees?

Answer:

There are several situations where the SSA and IRS could be more available for education efforts, both for state and local government employers and for State Administrators.

Employer education efforts: SSA maintains the official wage records for each employee. SSA staff are also the experts on the benefits their programs provide. Each time a State Administrator holds a referendum, it is possible the entity and their employees may request more information about the vote and how employees' benefits could be affected by the outcome of the vote. In recent years, SSA has only physically attended two states' (Idaho and Missouri) educational sessions, and even then, only sporadically. Any other requests for SSA to assist State Administrators have been attended via phone, often by a Public Affairs Specialist who was not well versed in Section 218 coverage issues. To the best of my knowledge, the IRS has not assisted in any educational sessions for a referendum election with the exception of the State of Idaho, where a specific referendum being held needed an in-depth explanation regarding potential refunds.

Improvements could be made both in the availability of SSA for these employer educational sessions, as well as better training internally within SSA itself. State Administrators have experienced under-trained staff within SSA regarding Section 218 coverage, mainly due to the many 120-day appointments and backfilling of positions due to retirements. Succession planning has been virtually non-existent due to turnover and the lack of longevity in many positions.

The IRS has been given many suggestions by their Advisory Committee on Tax Exempt and Government Entities (ACT) for improvements in educating state and local government entities. Most notably in 2010 was the addition of Form 14581-FSLG Compliance Self-Assessment Tool.¹ The ACT recommended revisions to this form in the 2015 Report, but no revisions have been made to date. Also noted in the 2015 Report, based on an extensive survey of state and local government entities, respondents noted that “face-to-face outreach is the most successful means in achieving an understanding of the special details related to State and Local government issues.” The Agents need to perform their outreach activities in a face-to-face setting, but funding constraints within the IRS have caused them to move to virtual training, which is far less effective.

NCSSSA is concerned about the recent reorganization by the IRS’ Tax Exempt and Government Entities (TE/GE) Division that moved FSLG from the Governmental Entities section to the Exempt Organizations section. We fear that change will undermine the progress that has been made with state and local governments’ compliance with FICA tax laws, Social Security and Medicare coverage, and public pension plan requirements since FSLG was first established in the late 1990’s. If the IRS thinks it no longer belongs within TE/GE’s Government Entities section (which still includes Indian Tribal Governments and Tax Exempt Bonds), then a far more logical place for FSLG than Exempt Organizations would be Employee Plans. Employee Plans oversees compliance with federal laws by all types of pension plans, including those administered by state and local governments and the federal government itself. This concern was also expressed by citizen members of the Advisory Committee on Tax Exempt and Government Entities (ACT) in this year’s report.²

Education efforts with the IRS: The State Administrators value their partnership the IRS and the assigned FSLG Agents. Specifically, we rely on FSLG Agents’ expertise on employer tax processes. It is important for the FSLG Agent to be in attendance with NCSSSA’s “New Administrator” trainings that are conducted each year, typically as regional two-day sessions. These FSLG Agents increase the value of these educational events as well as during NCSSSA’s Annual Conference³ by providing input and perspective to a unique area of payroll tax. In recent years, the FSLG Agents have not attended “New Administrator” trainings, and only executive level personnel or one local agent have attended the Annual Conference. It is important that those from the field also experience the trainings and networking opportunities so they can have improved outreach efforts overall. Better informed IRS/FSLG staff will, in turn, enable them to improve their educational efforts with state and local governments’ employers and their legal and financial advisors, public employees, and public pension plan officials. It will also assist them in being more efficient and effective when conducting compliance checks and examinations.

¹ Advisory Committee on Tax Exempt and Government Entities (ACT) 2010 Report of Recommendations, June 9, 2010: https://www.irs.gov/pub/irs-tege/tege_act_rpt9.pdf .

² Advisory Committee on Tax Exempt and Government Entities (ACT) 2017 Report of Recommendations, June 7, 2017: <https://www.irs.gov/pub/irs-pdf/p4344.pdf> .

³ The 2017 NCSSSA 67th Annual Conference will be held in Charleston, West Virginia, September 9-13; information on the planned agenda, conference registration, hotel, and other details are available at:

<http://ncsssa.org/presentconferencesite.html> . NCSSSA encourages Congressional Members and staff to attend this year’s Annual Conference to learn more about state and local governments’ Social Security and Medicare coverage, public pension plan coverage, and FICA tax matters. Also, we encourage Congressional Members and staff to review presentations and proceedings from past Annual Conferences which are available at: <http://ncsssa.org/conferencepresentations.html> and <http://ncsssa.org/proceedingsbook.html> .

Education efforts with SSA: State Administrators also value the partnership with SSA. The education efforts SSA has made with State Administrators has been relatively well attended, especially during NCSSSA's Annual Conferences, but the underlying issues with policy and processing questions described in our original written testimony remain. State Administrators are still experiencing inconsistent practices from Region-to-Region as well as staff turnover within the Regions.

As explained in our written testimony for the June 29th hearing, the idea of the Section 218 Council was originally intended to be a joint problem-solving group between SSA, IRS and NCSSSA; however, it has not been as successful as it could be due to limitations of SSA's ability to accept advice. As noted in NCSSSA's written testimony, we recommend that the SSA be given Federal Advisory Committee Act (FACA) authority to allow the Section 218 Council to become Advisory Group so that NCSSSA's policy recommendations can be considered. See number 5 under Areas for Improvement, on page 9, of our written testimony.

The SSA, IRS, and NCSSSA need to more effectively use the Section 218 Council which was formed in 2011 to help prevent state and local governments' compliance problems that were documented by the Government Accountability Office study (described in our June 29th written testimony on page 3). Many of the areas of concern NCSSSA outlined in our written testimony can be successfully addressed, including better coordination among the SSA, IRS, and State Administrators, if the Council is used as a problem resolution mechanism by all parties and the State perspective is included in the process. Cooperation between the federal partners (both SSA and IRS) and State Administrators has consistently had the most profound impact on voluntary compliance by state and local governments' Social Security and Medicare coverage and FICA tax compliance.

As noted on page 8 of our June 29th written testimony, we encourage Congress to provide grants to the State Administrators, SSA, and IRS that are earmarked to provide on-going education and outreach to state and local governments, public pension plan officials, and their legal and financial advisors. We reiterate that request in this response as one of the best ways to improve coordination among the states and our federal partners which will, in turn, facilitate state and local governments' compliance.

As mentioned above in footnote 3, NCSSSA encourages Members and staff of Congress to attend this year's Annual Conference that will be conducted in Charleston, West Virginia, September 9th to 13th. Participation in the Annual Conference will help Congress gain a better understanding of the issues, concerns, and value of the partnership between State Administrators and the federal government (both SSA and the IRS). In addition to checking out the link to the Annual Conference that is included in footnote 3, feel free to contact NCSSSA President James Sawyer, Texas State Administrator, by phone at: (512) 867-7373 or email at: jsawyer@ers.state.tx.us or Vice President Dean J. Conder, Colorado State Administrator, by phone at: (303) 318-8060 or email at: dean.conder@state.co.us.

Thank you for inviting NCSSSA to participate in the hearing on this important subject that has nationwide significance for all state and local governments, their employees, and public pension systems and, indeed, the federal government, and the Social Security and Medicare Trust Funds.

Let me know if you have any questions or need anything further from me or others in NCSSSA. I can be reached at: MMotza@msn.com or 719-651-3291.

Sincerely,

A handwritten signature in blue ink, appearing to read "Maryann Motza". The signature is fluid and cursive, with the first name "Maryann" and the last name "Motza" clearly distinguishable.

Maryann Motza, PhD
NCSSSA Legislative Committee Chair, 2016-2017

Enclosures

cc: Mr. James Sawyer, NCSSSA President
Mr. Dean J. Conder, NCSSSA Vice President
Mr. TJ Reardon, NCSSSA Vice President Designate

Summary of Section 218 Compliance Risks
Received from IRS/FSLG April 2014

1. Public School “Teacher” Positions

The greatest compliance risk discovered during the Section 218 assessment project concerns states improperly discontinuing social security withholding on absolute coverage positions due to expansion of pension plan coverage. This is the same issue that has received so much attention the last few years. The potential for this particular issue exists in states that have pension plans that are not covered by a system-wide Section 218 modification. So far, we have identified twenty-five states and one territory that have these specific attributes. Of course, this does not necessarily mean that a problem exists. We are following up with the State Administrators to evaluate the Section 218 attributes in these states.

2. Policeman and Firefighter Positions

The primary Section 218 risks involving policeman and firefighter positions are similar to the risks previously discussed in regard to the public schools positions. The risk arises when governmental entities expand retirement system coverage to include absolute coverage positions. We need to work with the state administrators to ensure that entities do not erroneously discontinue Social Security coverage in these situations.

3. Section 414(h)(2) Issues

Generally, employee contributions to retirement plans must be included in both federal income taxable wages and in FICA taxable wages in the year of contribution. However, IRC § 414(h)(2) provides an exception for § 401(a) qualified plans established by certain State and local government entities. If an employer meets the requirements of § 414(h)(2), the contributions will be treated as employer contributions for both federal income tax purposes, and for FICA tax purposes unless the contributions are deducted from the employee’s wages subject to a salary reduction agreement.

Internal Revenue Code Section 3121(v)(1)(B) includes in wages any amounts treated as employer contributions under § 414(h)(2) where the employer picks up the contributions pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).

Entities making 414(h)(2) contributions to their retirement plans via salary reduction, and who have Section 218 modifications, would be liable for both Social Security and Medicare taxes on those contributions. Entities making these type of retirement plan contributions for employees who were hired after March 31, 1986, and who do not have Section 218 modifications, would be liable only for Medicare taxes on those contributions if the retirement plan was Social Security equivalent. If the retirement plan was not Social Security equivalent, the contribution amount would be subject to both Social Security and Medicare taxes per the mandatory rules.

The question of ‘What constitutes a Salary Reduction Agreement?’ is critical. We have encountered situations where taxpayers do not include the employee contribution to the retirement plan in FICA wages because they maintain the contributions are mandatory, thus no salary reduction agreement exists. This position has been litigated and defeated by the 10th Circuit Court of Appeals in the Shalala case.

4. Qualifying FICA Replacement Plans

In 1990, Congress amended the Internal Revenue Code and the Social Security Act, making Social Security and Medicare coverage mandatory for most state and local government employees who were not covered by a qualifying FICA replacement public retirement system or a Section 218 Agreement. This law became known as mandatory Social Security, which is different from mandatory Medicare. Medicare is mandatory regardless of the existence of a retirement system, but Social Security is mandatory only in the absence of a retirement system or Section 218 Agreement. However, a qualifying FICA replacement retirement system must provide a retirement benefit to the employee that is comparable to the benefit provided under the Old-Age portion of the Old-Age, Survivor, and Disability Insurance (OASDI) program of Social Security.

In today’s economic climate many states are modifying their pension plans to such an extent they may, inadvertently, no longer qualify as a FICA replacement retirement system. In this situation, with no Section 218 Agreement, employee compensation would then become subject to the mandatory Social Security provisions.

This is a prime example of why we need your assistance in monitoring information concerning the various pension plans in each state. All three stakeholders have a role to play in assisting the governmental entities in navigating these highly complex issues.

5. Retirement Plan Types

Many state and local governments are considering, or have enacted, retirement plans other than, or in addition to, the traditional defined benefit and/or defined contribution plans.

FSLG specialists have become more aware of “401-k like” plans being implemented or considered in several states. We expect to see many of these hybrid plans in future years.

FSLG has also found numerous instances concerning ineligible employers (for example housing authorities) participating in 403(b) plans.

Again, this is an area where we all need to work together to ensure the governmental entities are eligible for the pension plans they participate in.

6. Government Entity Restructuring

I think everyone would agree, that given the current budgetary limitations we are working under there is increasing pressure for government entities to find more cost effective means to deliver the required services.

For example, a variety of factors ranging from declining student enrollment to budgetary considerations have led to an overall drop in the number of school districts across the country. In many instances a Section 218 referendum may be necessary when a new entity is formed for Social Security and/or Medicare tax to be legally withheld from employees' compensation. If a state has not had a Section 218 modification in several years, this may be indicative of a potential compliance problem. FSLG is currently following up with the State Administrators to determine if the required referendums have been held. We also covered this topic in our August 8, 2012 webinar entitled "Social Security Section 218 Agreements and Government Entity Restructuring." This webinar can be viewed at <http://www.irsvideos.gov/Governments/Employers>.

7. Charter Schools

We are working closely with state administrators and SSA in a few states on this highly complex issue.

The primary issue we have encountered is whether or not the charter school is a governmental entity. A secondary issue is then whether the charter school is covered by the local school district's Section 218 modification or if the charter school requires their own modification.

This is a highly complex area of the law. We are only scratching the surface so far. We will continue to work with you in the future to ensure accurate and consistent application of the law.

8. Mandatory Medicare Coverage

We have found problems in this area more commonly in relation to police and firefighter positions where Medicare tax is not being withheld on payments made to anyone hired on or after April 1, 1986. We need to work together to increase awareness of this section of the law.

9. Part-time Positions

Incorrect Social Security and Medicare tax withholding may occur when an entity improperly interprets the Section 218 Agreement in regard to part-time exclusions. To make a proper determination, we must research the applicable state law to determine what the definition of part-time includes and to which position the exclusion may apply.

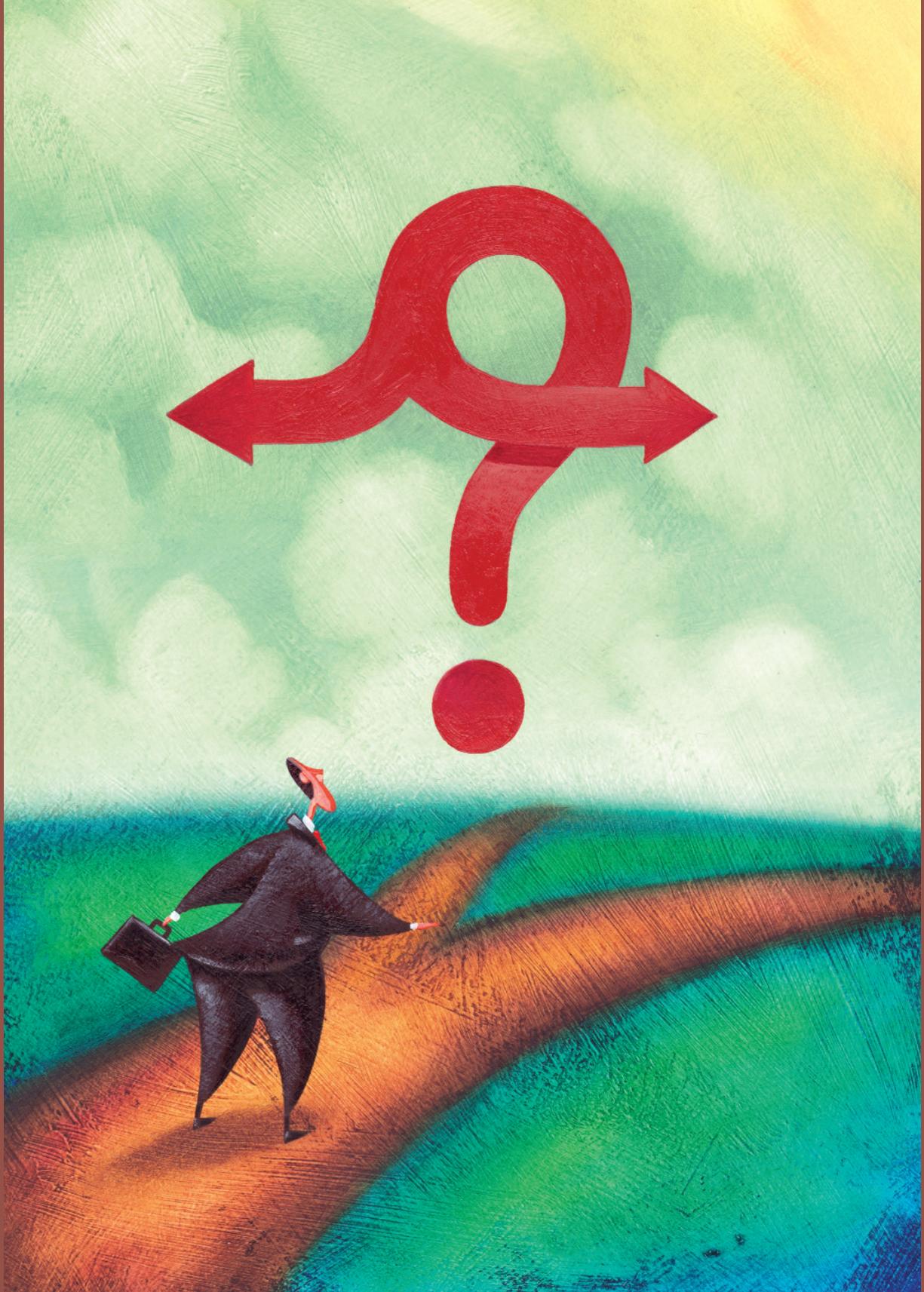
We have found that 24 of 52 states have a part-time exclusion included as part of their Section 218 Agreement. Of those 24, only 12 provided a definition of part-time while 15 stated the exclusion was made on an entity by entity basis and 7 stated it was for specific positions.

This is an example of a risk where one size does not fit all. We need to accurately document the provisions of the Section 218 Agreement and state law as it existed on the applicable date to ensure accurate and consistent application of the law.

10. Student Services

Our research has found thirty-three states opted to exclude student services from FICA coverage under the State's Section 218 Agreement. Sixteen states elected to provide Social Security and Medicare coverage for services performed by students in certain schools and three have virtually no Section 218 coverage.

We have determined compliance risks are greatest when the exclusion does not apply (such as during the summer when student workers are not enrolled and regularly attending classes) or there is no state-wide student exclusion.



COMMON ERRORS in State and Local Government
FICA and Public **RETIREMENT** System Compliance

BY MARYANN MOTZA AND DEAN J. CONDER

Many state and local government employers and employees are confused by the Federal Insurance Contribution Act (FICA) tax and public retirement system obligations. This employment tax, which is the basis for Social Security and Medicare, is straightforward in the private sector. Applying FICA to state and local government employment, however, can be exceedingly difficult. In addition, the Governmental Accounting Standards Board (GASB) does not test for FICA compliance, which can lead to a false sense of security when a state or local government receives an audit compliance certificate based on GASB audit standards.

The laws and rules that affect public employers' federal FICA tax obligations regarding Social Security and Medicare coverage provisions include numerous exemptions and exceptions to the laws that apply to the private sector. Further exacerbating the situation are the semantics associated with the laws, which can create confusion that results in inadvertent noncompliance:

- “Voluntary” Social Security coverage through a Section 218 agreement was once the only way state and local governments could elect Social Security coverage for their employees. Since April 20, 1983, coverage under a Section 218 agreement cannot be terminated unless the governmental entity is legally dissolved.
- “Mandatory” Social Security coverage is not really mandatory for all state and local government employees. If a public employer has a qualifying FICA replacement retirement system for its employees, it is not required to pay the Old-Age, Survivor, Disability portion of Social Security.
- “Mandatory” Medicare coverage is also not really mandatory for all state and local government employees. It is actually illegal to pay Medicare tax for Medicare-exempt employees. The Medicare-only portion, however, is required for anyone hired by a public employer after March 31, 1986.

If you are not confused yet, you soon will be.

HOW WE GOT HERE

Congress enacted the Social Security Act in 1935 to establish an insurance program for “persons working in industry

and commerce as a long-run safeguard against the occurrence of old-age dependency.” Congress, however, faced constitutional questions as to whether it could force state and local governments to include their employees in the Social Security system, so state and local government entities were not compelled to take part. In fact, at that time, public employers were actually forbidden to do so.

Beginning in 1951, states were allowed to enter into voluntary agreements (authorized by Section 218 of the Social Security Act and thus called Section 218 agreements) with the federal government to provide Social Security coverage to their public employees. Each state enacted its own legislation to provide the authorization for the state and its political subdivisions to voluntarily enter into individual Section 218 agreements with the federal government that provided coverage to different classes and positions of employees. These

original Section 218 agreements have a provision that allows an entity to withdraw from the agreement, but since 1983, that provision has been overridden by federal law.

With the enactment of the Medicare portion of FICA in 1965, all Section 218 agreements were automatically covered with Medicare. In 1985, Congress enacted what is popularly termed mandatory Medicare. Under this law, anyone hired on or after April 1, 1986, is subject to the Medicare portion of the FICA tax, regardless of whether or not the entity covers its

employees by a public retirement system. Those employees covered only by Medicare (and not Social Security) are said to be Medicare Qualified Government Employment (MQGE). The employer is required to file W-2 and 941 forms for each MQGE employee.

In 1990, Congress amended the Internal Revenue Code (IRC) and the Social Security Act, making Social Security and Medicare coverage mandatory for most state and local government employees who were not covered by a qualifying FICA replacement public retirement system or a Section 218 agreement. This law became known as mandatory Social Security, which is different from mandatory Medicare. Medicare is mandatory regardless of the existence of a retirement system, but Social Security is mandatory *only in the absence* of a retirement system or Section 218 agreement.

This employment tax, which is the basis for Social Security and Medicare, is straightforward in the private sector. Applying FICA to state and local government employment, however, can be exceedingly difficult.

STATE SOCIAL SECURITY ADMINISTRATOR

States are required by federal regulation to appoint an official as the state Social Security administrator. The state administrator is the person responsible for administering the Section 218 agreements for each state. Until 1987, the state administrator was also responsible for collecting the Social Security and Medicare contributions (now referred to as the FICA taxes) from state and local government employers and to deposit the funds with the United States Treasury. When the Internal Revenue Service (IRS) assumed this function in 1987, many states interpreted this change as eliminating any further responsibilities, but that is incorrect; the majority of functions and responsibilities of the state administrator remain.¹ In fact, the responsibilities have become even more complicated since 1987, with the advent of the mandatory Social Security and Medicare provisions.

The state administrator is often thought of as a bridge between the federal agencies and local entities. Many small local entities do not have the expertise to effectively communicate and respond to the relevant issues, as this area of taxation is extremely complex and changing a single fact can alter a particular outcome. See Exhibit 1 for examples of typical fact patterns that result in vastly different conclusions about an entity's probable tax compliance when seemingly minor additional factors are added to the scenario.



DETERMINING COMPLIANCE

Employee or Contractor? In determining FICA compliance, the first question to ask is if the worker is an employee or an independent contractor. No FICA taxes are withheld for independent contractors; instead, the payment is recorded and filed on IRS Form 1099-MISC.

Is There a Section 218 Agreement In Place? This question can most readily be answered by the state Social Security administrator, whose office is responsible for administering the particular state's master agreement and each individual entity's agreement. Each entity's Section 218 agreement can differ, even within the same jurisdiction.

Coverage under Section 218 agreements can be extended only to groups of employees known as coverage groups. Once a position is covered under a Section 218 agreement, any employee filling that position is permanently covered for Social Security and Medicare. Each entity decides, within federal and state laws, which groups to include under its Section 218 agreement. Federal law excludes certain services or positions from coverage and requires coverage of others. For example, individuals whose compensation is solely fee based are excluded from mandatory coverage under federal law but can be included as optional coverage under an entity's Section 218 agreement.

Does the Entity Have a Qualifying Public Retirement System? State and local government employees must be covered by either a qualifying public retirement system or Social Security, by either a Section 218 agreement or the mandatory provisions of the federal law. (There is, however, new legislation regarding contracts involving goods and services.) Regardless of whether or not employees are covered by a retirement system, the employer is subject to the Medicare portion of the FICA tax for employees hired on or after April 1, 1986. Similarly, it is equally improper to withhold and pay Medicare on an employee who is covered by a retirement system and was hired before April 1, 1986, if that employee is not covered under a Section 218 agreement — unless the referendum² procedures are followed.

Finally, not all retirement systems qualify under the Omnibus Budget Reconciliation Act (OBRA) of 1990. If the position is not covered under a Section 218 agreement, an employer can provide an alternative retirement system, so long as it meets IRC requirements. According to Treasury Regulation 26 C.F.R. 31.3121(b)(7)-2, a pension, annuity, retire-

Exhibit I: Complexity Chart — Representative Examples of State and Local Government FICA Issues*

Primary Fact Situation	Additional Relevant Facts (Nuance/Possible Issue)	Probably Non-Compliant	Probably Compliant
Employer is not withholding Medicare on all employees.	If all employees are covered under a Section 218 agreement.	■	
	If all employees are covered under a public retirement system and Medicare is being withheld only from employees hired on or after April 1, 1986.		■
Political entity has stopped paying Social Security and is paying into a qualifying public retirement plan.	If political entity is covered for Social Security under a Section 218 agreement.	■	
	If political entity is covered for Social Security by mandatory Social Security provisions.		■
Political entity has a Section 218 agreement and is not paying FICA.	If entity did not opt out of the agreement before April 20, 1983, it is permanently locked into the agreement and must pay FICA on all covered employees.	■	
	If entity opted out of its Section 218 agreement before April 20, 1983, and its employees are covered by a public retirement system and are paying Medicare, as applicable.		■
Political entity has continuously been paying Social Security and also into a public retirement system for all employees.	Officials erroneously think the entity must pay into a public pension system and into Social Security, believing the requirement is “mandatory” for all public employers since July 1991. No Section 218 agreement exists.	■	
	Public entity voluntarily elected to be double covered by entering into a Section 218 agreement while continuing to pay into a public pension plan.		■

* At least 500 compliance scenarios exist related to state and local government FICA, Social Security and Medicare coverage, and public pension system issues.

ment, or similar fund or system “is not a retirement system with respect to an employee unless it provides a retirement benefit to the employee that is comparable to the benefit provided under the Old-Age portion of the Old-Age, Survivor, and Disability Insurance (OASDI) program of Social Security.” A defined contribution retirement system meets the test provided by this regulation if allocations to the employee’s account

are 7.5 percent of compensation and do not include any credited interest in the calculation. Matching contributions by the employer may be taken into account for this purpose. Thus, a defined contribution plan that has a contribution rate from the employer, employee, or both that is 7.5 percent of compensation can take the place of the OASDI portion of Social Security under OBRA 1990 (unless of course, the position is

covered under a Section 218 agreement). Mandatory Medicare still must be paid.

What About Rehired Annuitants? State and local employees who are part of a retirement system, were hired before April 1, 1986, and have been continuously employed are exempt from mandatory Medicare. In fact, it is equally incorrect to pay and cover those employees with Medicare. However, in the public sector, many employees who have retired and who receive a pension from their retirement systems are rehired under the retirement system (e.g., retired teachers are rehired as substitute teachers). These employees are called rehired annuitants; they are receiving their annuity, or pension, but they have been rehired — even if only part-time.

This is a common area of confusion within the public sector. One of the requirements for the exemption is continuous employment, and the act of retiring and receiving a pension breaks the continuity of employment. Therefore, any further employment after retirement is subject to the Medicare portion of the FICA tax. Further, if the retirement system does not cover these annuitants, they are subject to full FICA.

OBTAINING SOCIAL SECURITY COVERAGE

Although initially the only way for a state or local government employer to have Social Security coverage for its employees was to enter into a Section 218 agreement, this is inadvisable today because of the permanence of the agreement. Instead, current law allows for Social Security coverage of state and local employees under the mandatory provisions discussed above. An entity without a Section 218 agreement is free to choose between pension coverage and Social Security coverage and can move from one to the other, without penalty, by merely withholding (or stopping its withholding) and matching the FICA tax — and, of course, filing appropriate W-2 and 941 forms. Remember, however, that *all* employees, regardless of the type of coverage, hired after March 31, 1986, are required to pay the Medicare portion of FICA.

The state administrator is often thought of as a bridge between the federal agencies and local entities. Many small local entities do not have the expertise to effectively communicate and respond to the relevant issues, as this area of taxation is extremely complex and changing a single fact can alter a particular outcome.

For employees hired before April 1, 1986, a Section 218 agreement can be executed to provide Medicare-only coverage for employees who are members of a qualifying retirement system and who are not already covered under a Section 218 agreement. Under the majority vote referendum procedures, if a majority of employees vote for Medicare coverage and the entity agrees to match and withhold the Medicare portion of FICA, it is lawful to extend Medicare-only coverage to these otherwise excluded employees.

The referendum process is also available to those employees who want Social Security coverage in addition to their public retirement system. The majority vote referendum process requires a majority of employees eligible to vote in the referendum, rather than those actually voting, to approve the referendum. If the referendum passes, then all pension eligible employees within that entity would have FICA coverage. All states are authorized by federal law to use this referendum process, and 21 states can use another process called the divided retirement system referendum, which in essence allows each employee to elect Social Security and/or Medicare coverage in addition to the retirement system. The procedures are the same except that there are no secret ballots, as the individual choosing coverage must be identified. The election by the individual to be covered by FICA covers the position, not the individual, so all future holders of that position will be covered by FICA.

All referenda are conducted under the direction of the State Social Security administrator under the provisions of federal and state law. Because each state's enabling legislation is unique and provides for difference procedures, the state statutes and the federal law regarding the procedural process must be consulted.

OTHER PROVISIONS: WEP AND GPO

The windfall elimination provision (WEP) affects an employee's Social Security benefit when a person works for an employer that has a public retirement system rather than any form of Social Security coverage. For example, Employee A works in the private sector for at least ten years and is then

employed by a local government that provides a retirement system rather than FICA coverage. In considering Employee A's entire work record, he would qualify for Social Security benefits because he has at least 40 credits. Employee A's Social Security benefit is offset, however, by the formula known as the windfall elimination provision. The formula is complex, and for this article, the important point is that employees need to be aware that if they work in uncovered employment (i.e., their wages are not subject to the full FICA tax), any Social Security retirement benefit might be reduced under this provision of the law.³

The WEP provision does not apply to survivor benefits. Other exceptions to WEP are:

- federal workers first hired after December 31, 1983
- retirees who were 62 years of age or disabled before 1986
- retirees who began receiving a monthly public retirement benefit before 1986, but continued to work beyond 1986
- retirees who have 30 or more years of substantial earnings under Social Security.

The government pension offset (GPO) provision is similar to WEP. This provision offsets a retirement benefit claimed on the work record of a spouse or ex-spouse when the employee is covered by a public retirement system. This offset formula reduces the benefit by two-thirds of the amount of the public retirement benefit. In some cases, the offset will eliminate a Social Security benefit entirely. The GPO provision does not apply to a retiree who receives a public retirement benefit based on work that was also covered by a Section 218 agreement for the preceding five years.

CONCLUSION

This area of taxation and public retirement system requirements for state and local governments can be complex and confusing. During training sessions, the authors often tell audience members that "if you are not confused by the end of the presentation, you have not been paying attention." Likewise, this article is meant only to broach the subject. Readers are encouraged to use the additional resources provided (see the "Additional Resources" box) to further explore the subject. ■

Notes

1. This fact has recently been documented by an issue that arose in the State of Missouri. See the final Task Force Report for a description of the problem and how it had to be addressed by multiple individuals and agencies: M. Grochowski, et al., *Report: Federal Section 218 Task Force for Missouri School Districts*, March 31, 2009, <http://oa.mo.gov/acct/033109/FederalTaskForceReport.pdf>.

Additional Resources

- IRS Publication 963, *Federal-State Reference Guide*: <http://www.ssa.gov/slge/pubs.htm>
- Colorado Public Employees' Social Security: <http://pess.cdle.state.co.us/>
- National Conference of State Social Security Administrators: <http://www.ncssa.org/>
- IRS Federal, State, and Local Governments (FSLG) office: <http://www.irs.gov/> (click on "Government Entities"). To keep abreast of developments, you can subscribe to the *FSLG Newsletter* by selecting it from the "Topics" section of this Web site.
- IRS Employee Plans (public pension system requirements): <http://www.irs.gov/ep>
- Social Security State and Local Government: <http://www.ssa.gov/slge/>
- State of Kentucky: <http://sssa.state.ky.us/>

2. A Section 218 agreement is made between the Social Security Administration and a state's Social Security administrator (acting on behalf of the state) to provide coverage for a group of state or local government employees. A *Section 218 agreement covers positions, not individuals*. Coverage under a Section 218 agreement supersedes all other considerations. If a public employer wants to provide both a qualifying FICA replacement plan and full Social Security coverage for its employees, a referendum election must be conducted by the state Social Security administrator (or by the Social Security Administration, if the entity is an interstate instrumentality). Mandatory Social Security coverage ceases for a state or local government employee when he or she becomes a member of a qualifying public retirement system.
3. For details, see Social Security Administration's Web site at <http://www.ssa.gov/gpo-wep/>.

MARYANN MOTZA is the Social Security administrator for the state of Colorado. She is also co-chair of the GFOA's Committee on Retirement and Benefits Administration. Motza holds a Ph.D. in public affairs from the University of Colorado. **DEAN J. CONDER** is the Deputy State Administrator in Colorado. He is also Colorado's representative on the Taxpayer Advocacy Panel and past president of the National Conference of State Social Security Administrators. Conder holds a master's degree from the University of Denver, College of Law.

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**National Conference of
State Social Security Administrators**

Date September 9, 2016

Letter Transmitted via email only

Mr. Gary Grippo
Deputy Assistant Secretary
Government Financial Policy
U.S. Department of the Treasury
AND

Ms. A. Melissa Moye
Senior Policy Advisor
Government Financial Policy
U.S. Department of the Treasury
Office of State & Local Finance
1500 Pennsylvania Avenue
Washington, DC 20220

RE: Recommended Treasury Regulation Change

Dear Mr. Grippo and Ms. Moye:

This is in follow-up to the May 23, 2016, meeting that the National Conference of State Social Security Administrators (NCSSSA) leadership team members (i.e., James Sawyer, Meghann Spring, TJ Reardon, and I) held with you.

During that meeting we agreed to send you recommendations as to how and why a change to the Treasury Regulations associated with Internal Revenue Code §6103 can facilitate state and local governments' compliance with U.S. Code sections (both the U.S. Social Security Act and U.S. Internal Revenue Code). As a result the work of the Internal Revenue Service (IRS) in enforcing federal employment tax laws will become more efficient and cost-effective. That, in turn, will improve the tax gap related to employment taxes and the Social Security and Medicare Trust Funds. The attached document outlines the rationale for the proposed regulatory change.

Because it is logical to assume that it was merely inadvertent oversight that the Treasury Regulations were not updated on January 1, 1987, when the Federal Insurance Contribution Act (FICA) tax obligations were transferred from the states to the Internal Revenue Service (IRS), this change should be far less controversial than other requests to access IRS tax records.

NCSSSA and I are ready to provide any additional information related to our proposed change to the Treasury Regulations to facilitate proper FICA tax compliance and oversight by the IRS. I can be contacted by phone (303-318-8061) or email (maryann.motza@state.co.us).

Thank you.

Sincerely,

Maryann Motza, PhD
President, NCSSSA, 2015-2016

Attachment

cc: NCSSSA Executive Committee Members
NCSSSA Legislative Committee Members
NCSSSA Committee Chairs

DISCLOSURE: Recommended Treasury Regulation Change

By National Conference of State Social Security Administrators (NCSSSA)

September 9, 2016

Introduction

Naming State Social Security Administrators (State Administrators) as a group to be allowed to receive information from the U.S. Internal Revenue Service (IRS) will improve voluntary compliance by state and local government entities, reduce improper Social Security or Medicare coverage and taxation, and also reduce the tax gap.

The National Conference of State Social Security Administrators (NCSSSA) proposes an amendment to the Treasury Regulation by adding a new provision to the regulations that interpret and apply Internal Revenue Code (IRC) §6103. This change will clarify the unique situation associated with state and local governments' Federal Insurance Contribution Act (FICA) and public pension system requirements that exist under both federal and state laws due to the Amendment X of the U.S. Constitution and §218 of the U.S. Social Security Act (codified as 42 U.S.C. 418). This change will permit the disclosure of tax information to state officials who are commonly referred to as State Administrators who are designated pursuant to 20 C.F.R. §404.1204. Prior to 1987, State Administrators were responsible for collecting and reporting Social Security contributions from state and local government employers and transmitting the funds to the U.S. Treasury. Since 1987, when the IRS assumed that responsibility, State Administrators no longer receive feedback on non-complaint public employers. The lack of communication between the IRS and State Administrators results in both erroneous Social Security and Medicare coverage and benefits as well as incorrect FICA tax assessments by the IRS. These errors have been documented in numerous places, including by the Government Accountability Office (GAO).¹

The GAO issued a report (GAO-10-938) in September 2010 in which it addressed (1) how the Social Security Administration (SSA) works with states to approve Social Security coverage to ensure accurate coverage of public employees, and (2) how IRS identifies incorrect Social Security taxes for public employees. The report finds that the lack of shared information sharing among the SSA, IRS, and State Administrators is problematic to proper Social Security coverage and tax administration for this community.

This constraint can readily be overcome by amending Treasury Regulations under 26 U.S.C. §6103(d) by adding the following language to the Treasury Regulation:

"The state administrator, and his/ her designee, shall be considered a taxing authority eligible to receive tax information."

Likewise, regulations pursuant to 26 USC 3121 (FICA tax) should make it clear that the State Administrator, and his/her designee, shall be considered a taxing authority.

IRC §6103 (l) already allows disclosure to others for various purposes including to the Railroad Retirement Board and information pertaining to the District of Columbia Retirement Protection Act of

¹ See: M. Grochowski, et al., *REPORT -- Federal Section 218 Task Force For Missouri School Districts*, March 31, 2009, <http://oa.mo.gov/acct/033109FederalTaskForceReport.pdf>. See, also: U.S. Government Accountability Office. "Report to Congressional Requesters. Social Security Administration: Management Oversight Needed to Ensure Accurate Treatment of State and Local Government Employees." September 2010, GAO-10-938.

1997. All of which indicate an intent by Congress to allow disclosure when such information is necessary to the function of various programs.

Thus, the NCSSSA proposes that the Treasury Regulations applicable to IRC §6103 be amended to include authorization for the Secretary to disclose tax information obtained from state or local government with the official designated pursuant to 20 C.F.R. §404.1204 (i.e., the State Administrator) in furtherance of their duties. This change would not impair the ability of the State Administrators to continue sharing information with the IRS, which has been common practice since federal law changed in 1987.

Justification for Treasury Regulation Change

This proposal to amend Treasury Regulation under 26 U.S.C. §6103 is justified for many reasons including:

NOTE: Items numbered for ease of reference, not necessarily to indicate relative importance.

1. IRC §6103 already allows for disclosure of tax information to certain state officials involved in state tax administration.
2. This proposal seeks to have the IRS share results of state and local government compliance checks and examinations, so that issues (and, if evident, patterns) can be addressed in education / outreach sessions with state and local governments by State Administrators.
3. As occurred when IRS Pub. 963 was created in 1995, the tax gap can be reduced by enhancing communication between the IRS and State Administrators (\$12 Billion increased revenue from 1997 through 2000 from outreach activities by IRS, SSA, and State Administrators).² State Administrators can educate their state and local employers about compliance problems and provide guidance on how problems can be voluntarily corrected.
4. Much of the non-compliance with FICA tax laws by state and local governments are due to misunderstanding, rather than intentional malfeasance.
5. IRS resources, in turn, can be freed up to focus on examinations and pursuing tax fraud and other intentional violations.
6. State and local government employees are often covered for Social Security and Medicare through §218 of the Social Security Act (42 USC 418) by a written agreement between the particular state and SSA. These agreements are then modified by the State Administrator to include a particular local government entity or agency or department of the state or members of a public pension system. The entity then pays its employment tax in accord with these agreements and the IRS is charged with collecting those taxes, and by extension, enforce the §218 Agreements. The only two parties, however, to the §218 Agreements (contracts) are the SSA and the particular state yet, the state official responsible for enforcement as a party to the agreement has been excluded from information about the agreement. While the SSA may assign its rights under the agreement to the IRS; having done so, this assignment cannot then foreclose the rights of the state (the other party to the agreement).
7. Prior to 1987, the State Administrators were responsible for collecting the taxes (contributions) due pursuant to the §218 Agreement and there was no need to receive tax information from the IRS. After this date, the states and its political subdivisions paid their taxes directly to the Federal Government with the IRS responsible for enforcement. With this change came the

² Information furnished during a presentation given by the IRS Federal-State-Local Government Director at the National Conference of State Social Security Administrators (NCSSSA) Annual Conference in Rapid City, South Dakota, July 2002.

need to amend the disclosure law to allow the IRS to disclose information to the State Administrator, but such a permission and amendment were neglected. Since 1987, when the IRS assumed responsibility for collecting FICA from state and local governments, the IRS (and Treasury Counsel that advises the IRS in the Tax Exempt and Government Entities Division) have been inappropriately applying the restrictions contained in IRC §6103 to the State Administrators' offices in each state/U.S. territory.

8. A clarification of the Treasury Regulations will enhance the ability of the IRS to more accurately fulfill its duties under the IRC vis-à-vis both Social Security and Medicare (FICA) taxes and public pension system compliance by state and local government employers and public pension plans. It is important to note that IRC §6103 was enacted into law when the State Administrators were still the tax collection agents for Social Security and Medicare for all state and local governments within their borders.
9. After federal laws changed and transferred the FICA tax/Social Security and Medicare contribution collection process from the State Administrators to IRS effective January 1, 1987, the IRS (and Treasury Counsel that serves as its attorneys) concluded that because the State Administrator was not specifically named in IRC §6103 as included in the definition of "tax administration." Congress did not specifically name the State Administrator because it was not contemplated at the time that the IRS would eventually become the tax collection agency for public employers/employees' FICA taxes. A change to the Treasury Regulations is all that is needed to address the failure to revise the Treasury Regulations in 1987 to include State Administrators within the definition of an appropriate state officials for tax administration purposes. A statutory change to IRC §6103 is not necessary.

Proper administration of the IRC and Social Security Act make it imperative that the IRS and State Administrators communicate with each other on a government-to-government basis to ensure proper application of FICA and public pension plan laws within each state.

10. Passage of IRC §6103 pre-dated the U.S. Code changes that transferred FICA collection responsibilities from the State Administrators to IRS. That statutory change did NOT eliminate the necessary and appropriate oversight and administrative duties that still exist for State Administrators pursuant to 42 USC 418 and federal regulations and policies, i.e., 20 C.F.R. 404.1204 and (SSA's Procedures Operations Manual (POMS) State and Local (SL) Section 10001.130, State Social Security Administrator Responsibilities.

Thus, Congress never contemplated that tax collection responsibilities for state and local governments' FICA would transfer to the IRS effective January 1, 1987, when Congress enacted IRC §6103. From the adoption and creation of voluntary Social Security coverage agreements between the states and the Federal Government (i.e., SSA or its parent department/agency) which began in 1951, the states, through their State Administrators, collected, audited (including individual employee records), and paid into the U.S. Treasury Social Security (and later also Medicare) on all state and local governmental employers/employees to whom Social Security and/or Medicare contributions were applicable.

In fact, with the adoption of both mandatory Medicare (effective April 1, 1986) and mandatory Social Security (effective July 2, 1991), the State Administrator role became significantly more important as a resource to the Federal Government (both the SSA and the IRS) in order to properly ensure both coverage and taxation of state and local governments because of the diverse way each state is entitled to apply Social Security and Medicare-only coverage to their state and local government employees, based on the 10th Amendment to the U.S. Constitution.

11. IRC §6103 allows for State tax officials and State and local law enforcement agencies but does not define State tax official .[26 U.S.C. 6103 (d)]
 - o It does allow disclosure for taxes imposed under chapter 21 (FICA)
 - In general.—Returns and return information with respect to taxes imposed by chapters 1, 2, 6, 11, 12, 21, 23, 24, 31, 32, 44, 51, and 52 and subchapter D of chapter 36 shall be open to inspection by, or disclosure to, any State agency, body, or commission, or its legal representative, which is charged under the laws of such State with responsibility for the administration of State tax laws for the purpose of, and only to the extent necessary in, the administration of such laws, including any procedures with respect to locating any person who may be entitled to a refund. [26 U.S.C. 6103 (d)(1)] **(Emphasis added)**
12. IRC §6103 also allows for disclosure to State audit agencies [26 U.S.C. 6103(d)(2)]
 - o (2) Disclosure to State audit agencies.--
 - (A) In general.—Any returns or return information obtained under paragraph (1) by any State agency, body, or commission may be open to inspection by, or disclosure to, officers and employees of the State audit agency for the purpose of, and only to the extent necessary in, making an audit of the State agency, body, or commission referred to in paragraph (1).
 - (B) State audit agency.—For purposes of subparagraph (A), the term “State audit agency” means any State agency, body, or commission which is charged under the laws of the State with the responsibility of auditing State revenues and programs.
13. A review of the Code of Federal Regulations (CFR) shows regulations of various sections of IRC §6103 but there is no specific regulation related to paragraph (d).
14. State Administrators **do not seek individual taxpayer information** (i.e., individual employee), but rather, information by type of employer (e.g., municipality, county government, etc.) and tax issue.
15. The proposed revisions to the Treasury Regulations would eliminate the arbitrary restriction that is currently placed on IRS agents that prohibits their communication with the State Administrator about the appropriate employer-by-employer and employee-by-employee Social Security, Medicare, and public pension plan coverage in each state. The State Administrator has the most complete and reliable information on both the historical and current FICA and public pension system coverage requirements for its public employees. Without that information the IRS can make incorrect assessments of (or fails to assess) of FICA taxes potentially to the detriment of the Social Security and Medicare Trust Funds and the public employees who can and should be participating in the program. Because of the current interpretation of IRC §6103, the State Administrator is not consulted by the IRS even though the States are parties to the §218 Agreements (i.e., contracts) that provide for voluntary Social Security and/or Medicare coverage for state and local government employees in each state and the State Administrator is the chief liaison between the federal government and each state (or U.S. territory) on all state and local government Social Security and Medicare coverage and public pension system requirements.
16. It is logical to assume that it was merely inadvertent oversight that the Treasury Regulations were not updated on January 1, 1987, when the Federal Insurance Contribution Act (FICA) tax obligations were transferred from the states to the Internal Revenue Service (IRS), this change should be far less controversial than other requests to access IRS tax records.

17. The IRS has stated that IRS Form 8821 (Tax Information Authorization) provides the basis for the IRS to share public employers' tax information with State Administrators. Form 8821, however, is clearly intended for individual tax return information, not the government-to-government information that needs to be shared between the IRS and State Administrators. Use of Form 8821 for this purpose has been of little value because when contacted by the IRS most public employers are reluctant to voluntarily ask for yet another government, i.e., the state, to intervene because they fear further negative attention and/or expenses will be incurred.
18. Further, **NO** §218 Agreement can be established between SSA and individual governmental entities or separate agencies or departments of the state itself. **ALL** §218 Agreements are extensions of coverage to political subdivisions or agencies and departments of the state to benefit public employers and their employees that want voluntary Social Security and/or Medicare-only coverage. Thus, by failing to share information with the states, the IRS is actually violating basic contract law.

For further information, please contact Maryann Motza, PhD, President, National Conference of State Social Security Administrators at: 303-318-8061 or maryann.motza@state.co.us .

Thank you for considering our request.

Maryann Motza, PhD

Chair, Board of Trustees, Public Employees' Retirement Association of Colorado, 2015-2017

NCSSSA President and Legislative Committee Chair, 2015-2016

Colorado State Social Security Administrator

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PUBLIC SUBMISSIONS FOR THE RECORD

**WRITTEN STATEMENT OF THE
RINCON BAND OF LUISEÑO INDIANS**

**FOR THE RECORD OF THE JUNE 29, 2017 HEARING BEFORE
THE HOUSE WAYS AND MEANS COMMITTEE,
SUBCOMMITTEE ON SOCIAL SECURITY AND SUBCOMMITTEE ON OVERSIGHT**

The Rincon Band of Luiseño Indians (“Rincon”) appreciates the opportunity to submit its statement for the record on the June 29, 2017 Committee hearing which addressed the complexities and challenges of Social Security coverage for workers. Of particular concern to Rincon is the lack of Social Security coverage for its elected tribal council members. Rincon submits that, as part of its oversight function, this Committee must address the problems with Social Security coverage regarding Indian Tribal Governments, and not just state and local governments.

Tribal council members have been precluded from participating in Social Security coverage for decades, while their state and local government employee counterparts have had the opportunity to elect Social Security coverage pursuant to Section 218 of the Social Security Act. In 1959 the IRS ruled that services performed by a tribal council member do not constitute “employment” for employment tax purposes. Thus, FICA is not supposed to be collected from tribal council members for their participation in the Social Security system. At the same time, the IRS has prevailed in its assertion that FICA applies to tribal governments and, therefore, they are required to withhold employment taxes. Yet, there is no clear guidance for tribes in terms of classifying workers – i.e. who qualifies as a “tribal council member” and is excluded from FICA withholding, and who is not. This problem is amplified by the fact that Section 218 of the Social Security Act does not give Indian Tribal Governments an opportunity to simply opt-in to the Social Security coverage for their tribal leaders.

There are two bills pending in the 115th Congress (H.R. 2860 and S. 1309 - “The Tribal Social Security Fairness Act”) which seek to address this problem and give tribal governments the same opportunity as state and local governments to elect Social Security coverage for tribal council members. Rincon supports these bills. The Tribal Social Security Fairness Act will permit Indian tribal members who perform services for the tribal council to opt-in to the Social Security system in the same manner state and local government officials have been permitted under Section 218 of the Social Security Act. As Ms. LaCanfora testified at your hearing on June 29, 2017, Social Security coverage for retirement, disability and survivors’ benefits is of critical importance and is relied upon by more than 94% of working Americans. There is no justifiable reason for excluding tribal leaders from the same Social Security benefits.

We thank the Committee for its time and interest in resolving inequities in worker coverage under the Social Security system. We urge the Committee to ensure that coverage for Indian tribal leaders is not forgotten in your efforts to make necessary reforms to ensure fair and equitable access to Social Security benefits.



Bo Mazzetti, Chairman
The Rincon Band of Luiseño Indians