



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

UILC: 3121.02-07

CC:ECEO:Br.2RSWilson
COR-101648-00

March 29, 2000

Number: **INFO 2000-0021**

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Dear [REDACTED]:

This is in reference to your letter dated January 12, 2000, as to whether the [REDACTED] ("Center") may withdraw from the Social Security system by enrolling its employees in the [REDACTED] Public Employees' Retirement System ("PERS"). You ask for information on whether the 6.2% of compensation that has been paid to Social Security may be contributed instead to the PERS.

It appears that your letter refers to the special rules for the application of the Social Security tax to employees of a State government. Social Security tax is imposed under the Federal Insurance Contributions Act ("FICA"), located at §§ 3101-3128 of the Internal Revenue Code ("Code"). Under § 3121(b)(7)(F) of the Code, services of State employees are generally not subject to Social Security tax if the employees are covered under a State retirement plan that provides a minimum level of benefits.¹ The exemption from Social Security tax under § 3121(b)(7)(F) is not optional. If the requirements for the exemption are met, Social Security tax cannot be paid with respect to the employees unless the employees are provided Social Security coverage under the State's section 218 agreement as discussed in footnote 1.

¹ State employees who are covered under a retirement plan would, however, be subject to Social Security tax if they are also covered by an agreement ("section 218 agreement") between the State and the Social Security Administration to provide Social Security coverage under § 218 of the Social Security Act. In addition, under § 3121(u)(2) of the Code, State employees hired after March 31, 1986, are generally subject to the Medicare portion of the FICA tax even if they are covered under a State retirement plan.

It is important to note, however, that § 3121(b)(7)(F) applies only to “service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby. . . .” Thus, in order for § 3121(b)(7)(F) to apply, it must be established that the employer is either part of the State government, for example, an agency or instrumentality of the State, or part of the government of a political subdivision of the State.

The following six factors are considered in determining whether an organization is an instrumentality of one or more states or political subdivisions:

1. Whether the organization is used for a governmental purpose and performs a governmental function;
2. Whether performance of its function is on behalf of one or more states or political subdivisions;
3. Whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner;
4. Whether control and supervision of the organization are vested in public authority or authorities;
5. Whether express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and
6. The degree of financial autonomy and the source of its operating expenses.

See Rev. Rul. 57-128, 1957-1 C.B. 311.

The question of whether a particular entity is an instrumentality of a State or a political subdivision depends on the facts and circumstances of the particular case. However, a private, non-profit organization would not ordinarily be an instrumentality of the State even if it receives funding from the State. In addition, the fact that employees of the organization are eligible to participate in the State’s retirement plan is not determinative of whether the agency is an instrumentality of the State for purposes of § 3121(b)(7)(F).

We hope this information is helpful to you. Please note that this letter provides general information only and does not constitute a formal IRS ruling on which a taxpayer may rely. If you wish to obtain a formal ruling, information about the ruling process is contained in Revenue Procedure 2000-1, 2000-1 I.R.B. 4 (copy enclosed). In case of questions, please contact Rebecca Wilson (Badge No. 50-07964) at (202) 622-6040.

Sincerely,

Patricia M. McDermott
Senior Technician Reviewer
Branch 2
Office of Associate Chief Counsel
(Employee Benefits &
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Enclosure