Statement by Dr. Maryann Motza
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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
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Subcommittees on Social Security and Oversight
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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.

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[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 ("Qualify***ing*** Plan") which is different from a qualif***ied*** 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=bkmk .

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

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[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 (l).** 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.

<u>Beware of Unintended Consequences</u>

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

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[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.

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[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. Fornia, 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 .