S.F. xxx H.F. xxx; LCPR05-336

(Abeler)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA-General
Relevant Provisions of Law: Special Law Provision
General Nature of Proposal: Prior service credit purchase
Date of Summary: January 26, 2006

Specific Proposed Changes

- Authorizes a former municipal golf professional to purchase PERA-General service credit for prior service as golf pro characterized as independent contractor service, with a mandated municipal payment of a portion of the purchase amount.

Policy Issues Raised by the Proposed Legislation

1. Conformity with the revised Commission policy principle on prior service credit purchases.
2. Equitable considerations.
3. Accuracy of characterization as independent contractor; appropriateness of the proposed mandated employer funding/extent of culpability by the city of Anoka.
4. Affordability and cost.
5. Precedent.
6. Need for greater PERA scrutiny of membership exclusion.

Potential Amendments

No Commission staff amendments

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director JAM

RE: S.F. xxx; H.F. xxx (Abeler); PERA; Service Credit Purchase for Uncredited Greenhaven Golf Course Service (Document LCPR05-336)

DATE: January 26, 2006

Summary of Document LCPR05-336

Document LCPR05-336 permits Jon Bendix, described as a member of a narrowly drawn class likely to be limited to him only, to purchase service credit from the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) for his uncredited service at the Greenhaven Golf Course at Anoka, Minnesota, with the payment of the full actuarial value of the benefit to be obtained by the purchase, with the City of Anoka responsible for the majority of the purchase payment cost. The purchase opportunity would expire on June 30, 2007.

Public Pension Problem of Jon Bendix

Jon Bendix, a 50-year old resident of Anoka, Minnesota, was the Golf Professional and the Pro Shop Manager at the Greenhaven Golf Course, a municipal golf course operated by the City of Anoka until December 2005, who had retirement coverage by the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) for the later portion of his career, but who has a significant portion of his career at the Greenhaven Golf Course uncredited by PERA-General because he believes that he was incorrectly characterized as an independent contractor.

Mr. Bendix was initially employed by the City of Anoka as a part-time employee at the Greenhaven pro shop in 1978-1979, became a full-time pro shop employee in 1982, had city-paid health insurance coverage from 1983-1987, became the head golf pro in 1988, and continued to have health insurance coverage until 1993-1994, was recognized by the City of Anoka for the length of his service to the city (15 years) in 1993, and then became a member of PERA-General in 1998.

Mr. Bendix indicates that he was incorrectly characterized as an independent contractor for much of his career with the City of Anoka, that the extension of health insurance coverage during various periods of his service and his service duration award are indicative of that classification error by the City of Anoka, and that his reclassification as an employee in 1998 is consistent with a trend for the federal Internal Revenue Service to scrutinize alleged independent contractor situations among public golf course professionals.

Mr. Bendix seeks to obtain service credit from PERA-General for the period of employment by the City of Anoka for which he was omitted from coverage, and to have the City of Anoka pay the majority of the service credit purchase payment amount.

Background Information on Retirement Plan Service Credit and Service Credit Purchases

Background information on the crediting of service by defined benefit Minnesota public retirement plans and the purchase of service credit in various instances is set forth in Appendix A.

Background Information on the Exclusion of Independent Contractors by PERA-General

Background information on membership exclusions in the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) in general and on the exclusion of independent contractors and part-time professional employees specifically is set forth in Appendix B.

Discussion and Analysis

The public pension complaint of Jon Bendix of Anoka, Minnesota, and the proposed solution to his complaint, Document LCPR05-336, raise several pension and related public policy issues that may merit consideration and discussion by the Legislative Commission on Pensions and Retirement, as follows:

1. Conformity with the Revised Commission Policy Principle on Prior Service Credit Purchases. The policy issue is the conformity of Document LCPR05-336 with the applicable pension policy principle of the Legislative Commission on Pensions and Retirement as it has been recently observed by the Commission. Although the 1996 restatement of the policy principles by the Legislative Commission on Pensions and Retirement has several required elements before a purchase request is deemed acceptable, the Commission since 1999 has only been requiring that a prospective purchaser not have service credit in another public defined benefit plan for the same service already, that a payment be made equal to the full actuarial value of the benefit obtained by the purchase, and that the purchase not violate equitable considerations. Mr. Bendix does not appear to have other public defined benefit plan coverage for the requested purchase period. Document LCPR05-336 provides for a full actuarial value payment. The equitable considerations apparent to the Commission staff are indicated in discussion item #2.

2. Equitable Considerations. The policy issue is the extent to which any adverse equitable considerations exist with respect to the proposed service credit purchase. The primary apparent potential adverse equitable consideration is the delay between 1998, when Mr. Bendix first became a member of the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) and now in Mr. Bendix seeking public retirement coverage back to 1978. Although testimony will need to be taken from Mr. Bendix about the reasons for the delay, the Commission staff understands that the delay was due to a lack of awareness by Mr. Bendix that he was not actually an independent contractor and in difficulties he encountered in framing his issue in a manner that is understandable by legislators. Mr. Bendix indicates that his understanding of the dimensions of his lost retirement coverage also was heightened by an article in the November-December 2004 Golf Range Times magazine entitled "Employee or Independent Contractor?, Making Sure Instructors Pass the Litmus Test" (copy attached).

3. Accuracy of Characterization as Independent Contractor; Appropriateness of the Proposed Mandated Employer Funding/Extent of Culpability by the City of Anoka. The policy issue is the accuracy of the characterization of Mr. Bendix by the City of Anoka as an independent contractor prior to 1998 and the appropriateness of requiring the City of Anoka to pay the majority of the prior service credit purchase payment amount. Mr. Bendix's PERA-General membership began in 1998. Prior to that date, the City of Anoka considered Mr. Bendix as either a part-time employee (ticket-taker or pro shop starter) or as an independent contractor (assistant professional/manager or golf course professional/manager). The factual question is whether Mr. Bendix was properly classified by the City of Anoka as an independent contractor prior to 1998 and hence ineligible for PERA-General coverage. Mr. Bendix has provided the Commission staff with various documents related to his business relationship with the City of Anoka, including personal services contracts or independent contractor contracts for the period 1984 to 1996. The 1984-1996 documents include a specific indication that Mr. Bendix was an independent contractor, but also frequently reference that Mr. Bendix "accepts employment" and generally includes the City payment of some or all of Mr. Bendix's hospitalization insurance. In the documents, Mr. Bendix had a City employee number throughout his service at the golf course. In an employee service record covering the period 1983-1995, Mr. Bendix was listed as an employee, but in the "reason" column, the form indicated "contract" with relevant dates. In 1998, when Mr. Bendix officially became an employee of the City, the City agreed to take over the merchandise of the pro shop and bought out Mr. Bendix's inventory as of November 2000. Also in 1998, a memorandum of April 10, 1998, from the Anoka city manager provided Mr. Bendix with sick and vacation leave accruals equal to the averages of City employees with ten years of employment. The federal government is concerned about the proper classification of independent contractors or employees for taxpaying purposes (see "Independent Contractor vs. Employees" IRS article and portions of IRS Publication 15-A, both attached). PERA also determines whether persons compensated by local governmental units are independent contractors or employees, has reviewed Mr. Bendix's documents, and should be requested to summarize its conclusions about Mr. Bendix's situation and status. The City of Anoka should be provided an opportunity to indicate the reasons why Mr. Bendix was properly considered by it to be an independent contractor before 1998. The Commission, in the last six years, has regularly imposed a significant payment obligation to the employing unit in a proposed service credit purchase where that employing unit caused the service credit loss or significantly contributed to the service credit loss. In one instance, in 2001 (First Special Session Laws 2001, Chapter 10, Article 17, Section 3), Independent School District No. 624, White Bear Lake, was obligated to pay the full purchase payment amount, including the member portion, for a former school district clerical employee who became a teacher for the initial year of clerical employment after shifting from casual clerical employment to full-time clerical employment. In this instance, if Mr. Bendix was an employee rather than an independent contractor during the

period 1978-1998 and if Mr. Bendix met the minimum salary requirements for membership in the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), Mr. Bendix should have been covered by PERA-General. Mr. Bendix indicates that it was the city which alternatively classified him as an "independent contractor" or as an "independent contractor with benefits," that his recent duties as golf pro are substantially the same as his duties as golf pro before 1998, when he was classified as an independent contractor, and that golf pros at other municipal golf courses have been PERA-General members for their entire prior careers.

4. Affordability and Cost. The policy issue is the likely cost of the proposed service credit purchase and its affordability by both the public employee involved and the City of Anoka if the city is determined to be culpable in the loss of service credit by Mr. Bendix. Of Mr. Bendix's 27-year career in public service, up to 20 years were not covered by the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General). If the Commission recommends the proposed legislation, even with charging the City of Anoka for the bulk of the full actuarial value service credit purchase payment, the equivalent member contribution amount, plus 8.5 percent interest, for up to 20 years, will likely be considerable for Mr. Bendix. PERA has calculated the full actuarial value service credit purchase payment amount under Minnesota Statutes, Section 356.551, for 13 years, 10 months, of additional PERA-General service credit and increase Mr. Bendix's retirement annuity at age 66 of $1,513 per month, the full actuarial cost payment amount is $69,257. The equivalent member contribution amount, with 8.5 percent compound interest, is $50,817.59 as of June 30, 2006. The balance of the full actuarial value minimum payment amount, payable by the City of Anoka under Document LCPR05-336, based on the equivalent employer and employer additional contributions, plus 8.5 percent interest, is $54,121.38. If Mr. Bendix can afford to pay the equivalent member contribution amount, the City of Anoka may balk at paying the remaining balance.

5. Precedent. The policy issue is whether or not there is precedent for extending public retirement plan coverage to golf pros at municipal golf courses and for allowing prior service credit purchases by municipal golf pros. Mr. Bendix has been a member of the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) for seven years now and reports that the golf pros at the Rochester, Minnesota, municipal golf course and at other municipal golf courses have retirement coverage by PERA-General routinely, so the proposed special legislation is unlikely to set a new precedent for this type of coverage. In the late 1970s, the golf pro at the Mindakota Country Club was authorized to purchase prior service credit for PERA-General, which would be a direct precedent for this purchase. The issue of whether or not the Mindakota Country Club golf pro was an independent contractor or an employee, however, did not appear to arise as part of the special legislation.

6. Need for Greater PERA Scrutiny of Membership Exclusion. The policy issue is the role that the Public Employees Retirement Association (PERA) should play in preventing prior service credit purchase situations like Mr. Bendix's through a more thorough and enthusiastic review of membership exclusion reports. Under Minnesota Statutes, Section 353.27, Subdivision 10, employers are required to submit exclusion reports annually covering employees who were not reported as PERA members but were potentially PERA-eligible. The PERA Executive Director is obligated under that statute to ascertain if there are any omissions from PERA membership. A three-year statute of limitations exists for the payment of omitted contributions in PERA law, limiting the ability of PERA to correct errors in reporting employees as PERA members. Mr. Bendix should have been reported under PERA law over the years as part of some 20 exclusion reports, but was never identified in fact by PERA as PERA-eligible before his official status changed in 1998. Arguably, if PERA was more diligent in checking membership exclusions, special legislation requests for prior service credit purchases likely would be significantly reduced.

Appendix A

Background Information on Retirement Plan Service Credit and Service Credit Purchases

a. Defined Benefit Plans. Most Minnesota public pension plans are defined benefit plans. In defined benefit plans, the pension benefit amount that is ultimately payable is pre-determinable or fixed using a formula or comparable arrangement. The fixed element of the benefit amount leaves a variable element, which is the funding required to provide that benefit. The formula utilizes allowable service credit and salary credit in the calculation, averaging the salary amounts for the five successive years' average salary period that produces the highest amount for use as the base to which is applied a total percentage amount determined by assigning a percentage amount to each year of allowable service credit.

b. Historical Shift in Plan Types and to Salary-Based Plans. Minnesota's statewide retirement plans were not originally salary-related pension plans, with the predecessor to TRA established in 1915 as a money purchase (defined contribution) plan, with MSRS-General established in 1929 as a set dollar amount ($200 per month) plan, and with PERA-General established in 1931 also as a set dollar amount ($200 per month) plan. Conversion to salary-related pension plans occurred for MSRS-General and PERA-General in 1957, which was a recommendation of the initial interim predecessor to the Legislative Commission on Pensions and Retirement, and for TRA in 1969, which was a recommendation of the initial permanent predecessor to the Pension Commission. The first class city teacher retirement fund associations and Minneapolis Employees Retirement Fund (MERF) generally shifted to salary-related pension plans in the 1950s (the Duluth Teachers Retirement Fund Association (DTRFA) shifted in 1971).

c. Definition of Minnesota Defined Benefit Public Pension Plan Service Credit. Allowable service credit in Minnesota's statewide and major local defined benefit retirement plans generally includes many different service periods, which are:

1. Covered Current Service. Employment is a covered position with a covered employer for which member contributions have been deducted and transmitted to the retirement plan;
2. Historic Credit in Plan Records. Service credit as reflected in the records of the retirement plan that predates the plan's establishment or reformulation;
3. Military Service Leave. Periods of service in the U.S. Armed Forces during a leave of absence;
4. Temporary Disability Periods. Periods of leaves caused by a temporary disability;
5. Credit Reinstated by a Refund Repayment. Periods of service covered by a prior refund of member contributions which have been repaid subsequently;
6. Part-Time Employment. Periods where full service credit is granted for part-time employment;
7. Sabbatical Leaves and Other Leaves of Absence with Pay. Periods of an authorized leave of absence during which the member is paid a whole or a partial salary;
8. Extended Leaves of Absence Without Pay. Periods of an authorized leave of absence without pay;
9. Labor Union Employment or Elective Service. Periods of employment as an exclusive collective bargaining representative or as a elected official;
10. Parental or Family Leaves of Absence. Periods of leaves or breaks in service for parental or family reasons;
11. Strike Periods. Periods of a labor union strike; and
12. Out-of-State Teaching or Other Outside Service. Periods of teaching service, Peace Corps service, or VISTA service.

d. Purpose of Service Credit. Service credit in a Minnesota defined benefit retirement plan exists for three reasons, determining vesting rights, determining eligibility for an early normal retirement annuity, and determining the amount of a retirement annuity.

Vesting is the circumstance of possessing a non-forfeitable right to an eventual retirement annuity, even if covered employment is terminated before reaching retirement age. In virtually all Minnesota defined benefit retirement plans, the vesting period is three years of service credit, which need not be consecutive periods of service and which may include service covered by more than one Minnesota defined benefit retirement plan.

Early normal retirement annuity eligibility in Minnesota defined benefit retirement plans generally means qualification for the "Rule of 85," where a member can retire with an unreduced retirement annuity when the sum of the person's age and service credit total at least 85, or for the Minneapolis Employees Retirement Fund (MERF) or the Basic Program of the Minneapolis Teachers Retirement Fund Association (MTRFA-Basic), means qualification for the "30 and out" unreduced retirement annuity payable when a person has credit for at least 30 years of service credit.

Retirement annuity determination is the calculation of a member's defined benefit retirement annuity, using the plan's benefit accrual rate percentage (frequently 1.7 percent per year of service credit), multiplied by the member's service credit, and the total applied to the member's final average salary figure (highest five years average salary).

Defined benefit retirement plans exist to provide a retirement annuity at the conclusion of an employee's normal working lifetime. Service credit allows for the retirement plan to bear its proportional share of the burden of the ultimate total retirement annuity amount.

e. Special Legislation Service Credit Purchase Authorization. In Minnesota, until 1999, there were few general law service credit purchase authorizations, and service credit purchase authorizations were generally special law provisions.

The primary general law service credit purchase authorization was Minnesota Statutes 2004, section 354.51, enacted in 1931, when the Teachers Retirement Association (TRA) was a defined contribution retirement plan, which allows TRA members with 15 years of service who have pre-1953 out-of-state teaching service to purchase that service by making equivalent member contributions, plus interest at the rate of 8.5 percent per annum.

During the period 1957-2003, the Legislature has enacted 241 special laws authorizing one person or a small group of individuals to purchase prior service credit, distributed as follows:

Year	Number	Year	Number	Year	Number	Year	Number	Year	Number	Year	Number
1957	1	1971	2	1979	7	1986	6	1993	7	2000	8
1959	4	1973	4	1980	4	1987	3	1994	8	2001	10
1961	5	1974	5	1981	14	1988	7	1995	7	2002	2
1963	6	1975	10	1982	16	1989	12	1996	6	2003	6
1965	5	1976	4	1983	2	1990	10	1997	3	2004	1
1967	1	1977	9	1984	3	1991	6	1998	9	2005	1
1969	2	1978	9	1985	2	1992	6	1999	8		

A majority of special prior service credit purchase laws relate to the three major general employees retirement plans, with 33 special laws relating to the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), with 75 special laws relating to the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), and with 43 special laws relating to the Teachers Retirement Association (TRA).

In considering special law service credit purchase requests, the Legislative Commission on Pensions and Retirement has generally followed its Principles of Pension Policy, which require:

1. Individual Review. The Commission considers each service credit purchase request separately, whether the request is proposed legislation for a single person or is proposed legislation relating to a group of similarly situated individuals.

2. Public Employment. The period requested for purchase should be a period of public employment or service that is substantially akin to public employment. This is consistent with the notion that public pension plans should be providing coverage for public employees for periods of time when they were serving the public through public employment or through quasi-public employment. Coverage for a period when an individual provided private sector employment is not consistent with this statement.

3. Minnesota Connection. The employment period to be purchased should have a significant Minnesota connection. This is consistent with the notion that Minnesota taxpayers support these public pension plans and bear the investment risk in amassing plan assets. Given the support that taxpayers provide, it is appropriate that the service have a Minnesota connection, reflecting services provided to the people in the state.

4. Presumption of Active Member Status at the Time of Purchase. The principle states that contributions should be made by the member or in combination by the member and by the employer. It is presumed that the individual covered by the service purchase request is an active employee, because retirees generally are not considered to be "members" of a plan and these individuals no longer have a public employer. If there are unresolved issues of whether an individual should have service credit for a given period, those issues should be resolved before the individual terminates from public service, and certainly before the individual retires. The act of retiring undermines a claim that there is sufficient need for the Legislature to consider the coverage issue. If there were considerable hardship caused by the lack of service credit, presumably the individual would not have retired. Entering retirement suggests that the associated pension benefit is adequate without any further increase in the benefit level due to a purchase. Only on rare occasions have the Commission and the Legislature authorized service credit purchases by retirees.

5. Presumption of Purchase in a Defined Benefit Plan. The prior service credit purchase contributions in total should match the associated actuarial liability. The specific procedures in Minnesota Statutes and law for computing service credit purchase amounts, Minnesota Statutes, Sections 356.55 and 356.551, presume that the purchase is in a defined benefit plan with a benefit based on the individual's high-five average salary. There is no process in law specifying a procedure for computing a "full actuarial value" purchase in a defined contribution plan, or even defining what that concept means in the context of a service purchase or service credit purchase in a defined contribution plan.

6. Full Actuarial Value Purchase. Within the context of a defined benefit plan, the pension fund should receive a payment from the employee, or from the employee and employer in combination, which equals the additional liability placed on the fund due to the purchase. This amount is referred to as the full actuarial value of the service credit purchase. The procedure used to compute this full actuarial value should be a methodology that accurately estimates the proper amounts. When clear evidence indicates that the employing unit committed an error that caused the individual to not receive pension plan coverage, the Commission has permitted the employee to make the employee contribution for the relevant time period, plus 8.5 percent interest, and the employer has been mandated to cover the remainder of the computed full actuarial value payment. If the employer does not directly make the payment following notification that the employee has made his or her portion of the full payment, the Commission has required that a sufficient amount to cover the remainder of the full actuarial value be deducted from any state aids that would otherwise be transmitted to the employer. The Commission has purposely departed from the full actuarial value requirement when there is evidence that the pension plan administration created the lack of service credit coverage due to pension plan administration error. In situations of pension plan error, the employee may be required to pay the contributions that would have been required for the relevant time period, plus 8.5 percent interest to adjust for the time value of money, leaving any difference between that payment and the full actuarial value to be absorbed by the pension fund.

7. No Violation of Equitable Considerations. Purchases of service credit should not violate equitable considerations. Equity is a resort to general principles of fairness and justice whenever the existing law is inadequate. In general, any issue or factor associated with a service credit purchase request which can be viewed as lacking fairness or being less than impartial can be a basis for rejecting a request. Requests by existing retirees to purchase additional service credit and have their annuities recomputed could be viewed as being a situation that violated equity considerations. New requests on behalf of individuals who were covered by purchase of service credit authorizations passed by earlier Legislatures but who are dissatisfied with the purchase of service credit terms that were provided can be considered as violating equity considerations. Individuals requesting service credit purchases for periods specifically excluded from plan coverage under the applicable law could be considered as violating equity considerations, among other policy concerns relating to those considerations. Requests to purchase service credit for periods covered by another pension plan may raise equity concerns. Generally, a service credit purchase is intended to fill a gap in coverage, not to create double coverage. Long delays in seeking remedial action can also be considered a violation of equity considerations. Individuals tend to wait until late in their career before seeking any remedial action for lost service credit. Prompt action, closer to the time period when the service credit problem occurred, would often result in a solution at a lower cost and would avoid efforts by the Commission to try to determine the factual situation many years, or even decades, after the event occurred.

f. 1999-2004 General Service Credit Purchase Provisions. The recently expired full actuarial value service credit purchase provisions and the years in which they were enacted are as follows:

1999

- Military service (TRA and first class city teacher plans)
- Out-of-state teaching service (TRA and first class city teacher plans)
- Maternity leave or absence or maternity break-in-service (TRA and first class city teacher plans)
- Parochial or private school teaching service (TRA and first class city teacher plans)
- Peace Corps and VISTA service (TRA and first class city teacher plans)
- Charter school teaching (TRA and first class city teacher plans)
- Previously uncredited part-time teaching service (first class city teacher plans)

2000

- Military service (various MSRS plans, PERA plans)
- Teaching service credit for various nonprofit Community Based Corporation service (TRA and first class city teacher plans)

2001

- Out-of- country and tribal teaching service credit (TRA and first class city teacher plans)
- Developmental Achievement Center teaching service (TRA and first class city teacher plans)
- Uncovered teaching service at University of Minnesota (TRA and first class city teacher plans)
- Parental leave/break-in-service (teacher plans, various MSRS and PERA plans, various other plans)

In 1999, the Commission was persuaded to support several proposed generalized service credit purchase provisions applicable to the Teachers Retirement Association and the first class city teacher retirement fund associations (the Duluth Teachers Retirement Fund Association, the Minneapolis Teachers Retirement Fund Association, and the St. Paul Teachers Retirement Fund Association). Under these provisions, classes of individuals (those with prior military service, out-of-state teaching service in a K-12 situation, individuals who taught in parochial schools, provided Peace Corp service and various other groups), were permitted to purchase service credit in the applicable Minnesota plan for the specified service. These provisions, which were strongly supported by teacher groups, conflicted with the Commission's policy statement in several ways. All lacked any requirement of an individual review of the circumstance. Others were not related to public service or had no Minnesota connection.

In 2000, more service credit purchase provisions were added to law, this time for non-teacher plans, providing a full actuarial value service credit provision for individuals who had military service prior to becoming a public employee, or who failed to pay contribution requirements in a timely manner under other military leave service credit purchase provisions. These provisions enacted in 2000 were comparable to the military service credit provisions added to teacher plan law a year earlier. In 2000, teacher plan law was also revised to permit full actuarial value service credit purchases for non-profit community-based teaching service.

In 2001, several other service credit purchase provisions were enacted. An out-of-country teaching service credit purchase provision was created in teacher plan law, and also one for Development Achievement Center teaching. These new provisions included sections of law permitting purchase of service credit, not to exceed ten years, in the teacher plans for service while teaching at the University of Minnesota which was not covered by a pension plan at the university. These provisions stemmed from a legislative request for the executive director of the Minneapolis Employees Retirement Fund, who many years earlier taught some accounting courses at the University while employed in a position that was excluded from pension plan coverage. The final generalized service credit provision enacted was a family leave provision permitting individuals who may be covered by a teacher plan, or any of several other general employee and public safety plans, to purchase service credit for the past family leaves or family-related breaks-in-service.

There are several reasons why the Commission and Legislature may have supported the above provisions. First, the provisions were intended to be temporary. Each was set to expire a few years after enactment. The departure from policy may have been viewed as a short-term departure from established policy to address short-term market conditions for teachers. Second, the Legislature had been given assurances that the provisions created no financial harm to the pension funds because the purchases would be at full actuarial value. The methodology to compute full actuarial value purchase prices had been revised in 1998, and the teacher unions and the administrators of the teacher pension funds were confident that the procedures would produce accurate price estimates, thereby shielding other fund contributors from subsidizing these purchases. When the revised methodology was

enacted in 1998 as Minnesota Statutes, Section 356.55, the section included a provision requiring data to be retained and analyzed on every service credit purchase made using the procedure, and the section included an expiration date. If legislative review of these purchases suggested that the procedure was not accurate and was causing subsidies to occur, the section would be permitted to expire. If it expired, a previous procedure used to estimate full actuarial value, coded as Minnesota Statutes, Section 356.551, would again become effective. That prior procedure in Minnesota Statutes, Section 356.551 tended to produce higher cost estimates than the revised procedure. Teacher unions and other constituent groups favor continuing the revised procedure in Minnesota Statutes, Section 356.55, because it tends to produce lower prices. From a policy standpoint, the Minnesota Statutes, Section 356.55 procedure is better if it is more accurate than the prior procedure. If the lower prices are resulting in subsidies, its use harms the pension funds.

As the repeal date for the revised full actuarial methodology and each of these temporary generalized service credit provisions approached, the repeal dates were extended by the Legislature due to strong support for these provisions from the teacher unions and other constituent groups. Most of the provisions have now been extended more than once, but generally expired in July 2004.

Appendix B

Background Information on the PERA Exclusion of Independent Contractors and Part-Time Professionals

a. PERA-General Membership Inclusions and Exclusions At Large

When the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) was established in 1931, plan membership was optional for governmental subdivisions and, if the governmental subdivision elected to be a participating employer, was optional for employees employed before April 24, 1931, and was mandatory for employees employed after April 23, 1931. All counties, all first (except Minneapolis), second, and third class cities, including home rule cities, all public schools (except the Minneapolis public schools), and all villages with a population of at least 7,000 were eligible to be participating employers. Employees of a participating employer who were not paid in whole or in part from public funds, or who were covered by another public pension plan, or who were temporary employees, or who had an average length of employment annually of less than six months were excluded from PERA membership.

By 1941, the specification in law of PERA membership had become somewhat more complex. School districts were specified as eligible participating employers, reflecting the authorization of independent school districts. The 1941 exceptions from membership were:

(1) employees of governmental subdivisions that had not elected to be participating employers;

(2) employees hired before the governmental subdivisions became a participating employer and did not elect PERA membership;

(3) employees of a participating employer who were not paid in whole or in part from public funds;

(4) temporary employees of participating employers (defined as a person who is employed for less than six months within a 12-month period, or who is employed as a substitute for another employee who is on leave, or who is employed in a position that is not seasonal but is of an essentially temporary character, or who is employed part-time with total annual compensation of less than $300 unless the person was in a government classified civil service position);

(5) a member of another Minnesota public employee pension plan; or

(6) a person who by virtue of past employment is entitled to a pension from another Minnesota public employee pension plan or who has been designated as a future beneficiary of a benefit from another Minnesota public employee pension plan.

In 1951, towns and boroughs were added as eligible participating employers. In 1951 and 1955, PERA membership was made mandatory for local government employees who were not eligible for other Minnesota public pension plan coverage. This resulted in a rapid growth in the PERA membership, from 8,246 members in 1946 to 36,470 members in 1956.

By 1957, more changes in the PERA membership specification had occurred. The League of Minnesota Municipalities and PERA itself were made eligible participating employers. PERA coverage was made mandatory for all employees of all governmental subdivisions unless the employee was specifically excluded or the employee was over age 60 on June 30, 1957, and had less than six years of service as of that date. Legislators, the secretary of the Minnesota Senate, and the chief clerk of the Minnesota House of Representatives were specifically included in PERA membership. The PERA membership exclusions were revised, with the major exclusions as follows:

(1) person employed for professional services incidental to the person's regular profession and compensated on a per diem basis;

(2) election officers;

(3) employees of independent contractors performing public services;

(4) patient or inmate help in local government charitable, penal, or correctional facilities;

(5) members of boards, commissions, volunteer fire departments, bands, and other intermittent employees paid on a per diem, per meeting, or per fire basis;

(6) temporary, emergency, or seasonal employees as defined by PERA rules; and

(7) employees required to contribute to another Minnesota public pension plan on account of that employment.

In 1961, the PERA membership specification provisions continued to change. Local elected officials were given the option to be members of PERA and employees of local elected officials were included in PERA membership, as were district court reporters and port authority employees. An exclusion for police matrons employed by a city police department and transferred to a joint city-county detentions and corrections authority was also added to PERA law.

After 1961 and until 1974, public employees who had a salary of less than $75 per month were excluded from PERA membership. In 1963, an exclusion for persons who elected to be excluded from PERA membership for religious reasons was added. In 1965, probate, municipal and special municipal judges were included in PERA membership and students who were occasionally employed part-time by governmental subdivisions were excluded from PERA membership. In 1967, the student exclusion was modified to apply to full-time students employed part-time as governmental employees. In 1971, the specific exclusion for volunteer firefighters was deleted from PERA law. In 1973, school district employees with separate salaries for driving their own buses were included in PERA coverage and exclusions were added for resident physicians, medical interns, pharmacist interns in public hospitals and for appointed or elected officials compensated entirely on a fee basis if not members in 1971.

In 1974, until 1977, the minimum salary threshold for PERA membership was increased to $150 in any month during a year, or $1,800 annually. The minimum salary threshold for PERA membership was increased in 1977 to $250 in any month during a year or $3,000 annually in 1977. In 1981, the minimum salary threshold for PERA membership increased to $325 in any month during the year, or $3,900 annually. Also, in 1981, city managers were granted the authority to elect an exclusion from PERA coverage in favor of separate individual deferred compensation program coverage. The current minimum salary threshold for PERA membership was set at $425 in any month during the year, or $5,100 annually, in 1988. In 1997, St. Paul school district pipe fitters were excluded from PERA membership and, in 2000, other St. Paul city and school district trades personnel were also excluded from PERA membership. The 1997 legislation was considered and recommended by the Legislative Commission on Pensions and Retirement. The 2000 legislation was not reviewed or recommended by the Commission, but was added by the Senate Governmental Operations Committee to the 2000 omnibus pension bill.

b. PERA-General Independent Contractor and Part-Time Professional Exclusions

From 1931, the establishment of the Public Employees Retirement Association (PERA) to 1957, independent contractors were not specifically excluded from retirement coverage, although Minnesota Statutes 1953, Section 353.01, Subdivision 2, required a PERA member to perform personal duties for a governmental subdivision as an officer or as an employee. In 1957, two specific exclusions with an independent contractor flavor were added, one for a person employed for professional services that are incidental to the person's regular professional duties with compensation on a per diem basis and the other for employees of independent contractors under contract with a governmental subdivision. In 1963, the exclusion for employees of independent contractors was modified to an exclusion for independent contractors and the employees of independent contractors. In 1973, these exclusions were again revised and people were excluded from PERA-General coverage where their public service was incidental to the person's regular professional duties, if they were independent contractors or employees of independent contractors, or if they served as appointed or elected officers while being paid entirely on a free basis and were not PERA-General members in 1971. PERA law does not define the term "independent contractor," so PERA must make the determination based on the commonly used general definition of the term. The term has an application for federal tax law, state tax law, and for Worker's Compensation law and the standards developed under those laws will inform PERA's determination.

The exclusion from PERA-General for persons employed for professional services where that service is incidental to regular professional duties was modified in 1987 (Laws 1987, Chapter 284, Article 5, Section 1) to define incidental service as service with compensation up to 25 percent of the person's total annual gross earnings for all professional duties. PERA-General law remained unchanged in this exclusion until 1993 (Laws 1993, Chapter 307, Article 4, Sections 1 and 3), when the independent contractor non-inclusion provision was moved from Minnesota Statutes, Section 353.01, Subdivision 2b, to Minnesota Statutes, Section 353.01, Subdivision 2, and when the incidental public sector professional services exclusion was eliminated. In 2001 (First Special Session Laws 2001, Chapter 10, Article 11, Sections 2 and 4), the PERA-General independent contractor non-inclusion provision was again moved from Minnesota Statutes, Section 353.01, Subdivision 2, to Minnesota Statutes, Section 353.01, Subdivision 2b.

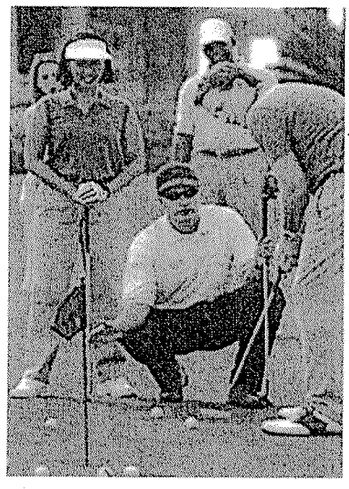
GOLF RANGE TIMES
THE LEADING MAGAZINE FOR THE GOLF RANGE INDUSTRY

NOVEMBER-DECEMBER 2004 COVER STORY

EMPLOYEE OR INDEPENDENT CONTRACTOR?

Making Sure Instructors Pass the Litmus Test

By Kristen Caldwell



Befitting its name, Three King's Golf is a three-man—well, two-man, one-woman—operation.

Knowing that the Kennesaw, Ga., facility couldn't support additional full-time employees beyond himself and his wife and son, family patriarch Bob King started exploring options for offering golf instruction without having to create an in-house teaching position.

"The range is a marginal earner anyway unless you're in an area with an influx of customers, but we're not," he says. "It takes care of the three of us, but it wouldn't take care of five instructors on a full-time basis." So King "hired" a local golf professional as an independent contractor. The arrangement was so successful that 13 years later, King continues to offer instruction through outside teaching professionals, all of whom set their own hours, lesson fees and teaching methods so as not to blur the fine line that separates them from employees.

Because independent contractors aren't subject to many of the employment laws and tax rules that cover employees, they provide ranges with an avenue for offering expanded services without added financial and administrative burden. But incorrectly classifying a worker can have devastating economic consequences.

There's a potential serious liability in misclassifying workers, even unintentionally, notes Rick Ross, a partner at Fredrikson & Bryon, P.A., a Minneapolis-based employment and labor law firm representing management. In particular, he says, incorrectly labeling an independent contractor who really is an employee can cost the business big time. Not only are violators responsible for federal back taxes, plus a penalty equal to 12 to 35 percent of the tax bill, but they also have to answer to state employment agencies that collect employment taxes and workers' compensation insurance—the sum of which could put a small company out of business.

Give Up Control

The key factor that the Internal Revenue Service and other agencies will look at to determine independent contractor or employee status is the degree of control by the hiring company.

"For true independent contractor arrangements, the range has no control over the hours they teach, the number of lessons they give, the rates they

charge, etc.," says Tom Kendrick, a PGA career consultant in the Employment Services Department of the PGA of America. "If that professional were an employee, then any typical employee costs and related expenses would be incurred. In return, range owners would have more control over the professional's availability for lessons, the fees charged and the type and number of lessons given.

"Each range's business model may determine which option would be best, but a great question to ask is this: Would the range be comfortable having a professional who is self-employed and operating their own business, teaching golf, at their range with little or no input or control over that professional's teaching business?"

Yes, says Alan Bales, manager of Player's Golf Driving Range in Martin City, Mo., which is anchored by a Golf Discount store. The Midwest golfing season is short, he notes, and there's not a lot of people taking lessons in January. "If we have a person who was an employee and he's not teaching, what are we going to have him do [during the slow periods]? Sell golf clubs?"

Though some facilities can and do benefit from having teachers use their expertise to help sell clubs and merchandise in the pro shop, another camp attests to the business-building capacity of an instruction program untainted by sales.

Teaching professionals at golf driving ranges help boost traffic and create regular customers, says Geoff Bryant, president of the United States Golf Teachers Federation in Port Saint Lucie, Fla., which is celebrating its 15th anniversary. In the case of independent contractors, "the professional does the advertising and brings people to the facility" without the range having to expend marketing resources.

Additionally, instructors who only teach are subtle salespeople because of the relationships they build with customers, says John Richman, director of instruction at Player's Golf. "Customers see me as a separate entity," he says. "That's the biggest bonus from the owner's standpoint—customers trusting the instructor and the instructor 'selling' equipment and services." If instructors, working as employees, also are responsible for making sales, then customers feel pressured, he says. As an independent contractor, "you're not perceived that way."

Know the Rules

But it's how the IRS and other enforcement agencies will perceive the range-instructor relationship that should be considered first. The only way for range owners to avoid penalties is to learn how these agencies use different testing procedures to classify workers.

The IRS's test includes a set of 20 factors that examine behavioral and financial control by the hiring company and the relationship of the parties (see "20 Questions"). Many state agencies use the same sort of "right of control" test but emphasize different factors related to their purview. Others, such as the Department of Labor, use an "economic reality" test that focuses on, for example, whether the instructor is economically dependent on the range; the extent to which the services in question are part of the company's business; and the permanence and duration of the relationship.

"Unfortunately, determining whether a person is an independent contractor or not is not black and white; it's mostly gray," says Ross. In light of IRS Revenue Ruling 68-625, where it was determined that a golf professional who makes his own appointments and carries on activities without any direction from the golf center or club is an independent contractor, range owners should adopt a laissez-faire approach, he notes. For example, a fee-sharing arrangement can work against range owners because it gets them involved in the instructor's business, Ross says. Scheduling lessons for the instructor is another questionable action, and making equipment and range balls available

or booking lessons are all benefits an employee would receive.

"Arrangements will vary with the business model of the range and the goals and objectives of the range and the teaching professional," says Kendrick. "Some ranges do not charge the professional any rental fee or collect any percentage of the lesson revenues. An essential factor to make this type of arrangement work is to have the lesson taker pay for the cost of balls used during lessons."

At Three King's Golf, the only direct compensation King receives is for the buckets of balls students hit. Several instructors include practice balls in their fee and then reimburse King for the bucket price, while others require students to purchase their lesson buckets separate from the cost of instruction. Students also pay the instructor directly unless they're paying by credit card, in which case King will run it through his machine. "Generally we allow that transaction to take place between the professional and his customer," he says.

Marketing also is left up to the instructors, who display their promotional materials and business cards in a designated area of the clubhouse so that customers can call them directly. King says not having a resident golf professional on site hasn't dissuaded customers and that the cost-saving model has been a boon to his business, especially in the early years. "If you're just getting started, you have to watch your cash flow pretty carefully, and this is a way to offer customers instruction without paying for an employee," he says. And a common way at that. According to a survey conducted earlier this year by PGA, 81.4 percent of the organization's professionals work as independent contractors at ranges nationwide, though Kendrick says the survey did not "test" the legality of those arrangements.

Put It in Writing

Most worker misclassifications are discovered accidentally. "In most cases I've been involved with, the individual gets discharged and they file for unemployment insurance, but if they're an independent contractor, they don't get it because the employer never paid for it," says Ross. Often, an investigation ensues. Other actions that can trigger an investigation are workers' compensation claims and IRS audits.

According to "Tax Savvy for Small Business: Year-Round Tax Strategies to Save you Money" by Frederick W. Daily, "The Wall Street Journal reported that in one six-year period, the IRS performed more than 11,000 audits of companies using independent contractors. The results: 483,000 reclassifications of independent contractors to employee status and $751 million in back taxes and penalties."

In the event of an investigation, says Ross, the claim of an independent contractor arrangement can be strengthened by the presence of a contract. Though actions speak louder than words (a contract is meaningless if the instructor is treated like an employee), having a written agreement at least shows the IRS and other agencies the intentions of both parties.

First and foremost, the contract should state explicitly that the instructor is an independent contractor and is not entitled to any of the benefits provided to employees, says Ross. Experts also suggest range owners include language that covers

- Services the independent contractor will provide
- Accounting of expenses (true independent contractors are responsible for their own expenses)
- Provisions for training materials and teaching space (furnishing equipment, such as swing and video analyzers and range balls, leans toward an employee relationship)
- State and federal income taxes the independent contractor will pay
- Liability insurance secured by the independent contractor
- Process for terminating the agreement

Anybody working as an independent contractor is walking a fine line, says Richman of Player's Golf.
But it's ultimately the range owner who pays if that line is crossed.

"A good-size range with a good-size staff is better off engaging a professional as an employee so that they insulate themselves from any claims," Ross says. Or, before categorizing someone as an independent contractor, "consult with an attorney, and specifically an attorney who knows labor and employment law, or even a tax attorney. It is a small expense to avoid what might be a very significant liability."

20 QUESTIONS

The following list of 20 common-law questions provided by Tom Kendrick offers a guideline for classifying workers. "In my experience, some facilities that think they have independent contractor arrangements are surprised when they do the '20 questions' test," says Kendrick, a PGA career consultant in the Employment Services Department of the PGA of America. "Generally, the IRS considers a 'Yes' answer to any of these questions to be evidence of an employer/employee relationship."

1. Do you provide the worker with instructions on when, where and how work is performed?
2. Did you train the worker in order to have the job performed correctly?
3. Are the worker's services a vital part of your company's operations?
4. Is the person prevented from delegating work to others?
5. Is the worker prohibited from hiring, supervising and paying assistants?
6. Does the worker perform services for you on a regular and continuous basis?
7. Do you set the hours of service for the worker?
8. Does the person work full time for your company?
9. Does the worker perform duties on your company's premises?
10. Do you control the order and sequence of the work performed?
11. Do you require workers to submit oral or written reports?
12. Do you pay the worker by the hour, week or month?
13. Do you pay for the worker's business and travel expenses?
14. Do you furnish tools or equipment for the worker?
15. Does the worker lack a "significant investment" in tools, equipment and facilities?
16. Is the worker insulated from suffering a loss as a result of the activities performed for your company?
17. Does the worker perform services solely for your firm?
18. Does the worker not make services available to the general public?
19. Do you have the right to discharge the worker at will?
20. Can the worker end the relationship without incurring any liability?

Businesses also can have the IRS determine whether a worker is an employee by filing Form SS-8, "Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding," available at www.irs.gov.

Ranges that have misclassified instructors as independent contractors may qualify for relief from federal employment taxes under IRS Section 530 if there was a reasonable basis for the classification, such as the advice of an attorney; if all workers classified as independent contractors were treated consistently; and if the owner filed Form 1099-MISC for each independent contractor.

Kristen Caldwell is managing editor of *Golf Range Times*

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Internal Revenue Service
United States Department of the Treasury

Independent Contractors vs. Employees

Before you can determine how to treat payments you make for services, you must first know the business relationship that exists between you and the person performing the services. The person performing the services may be -

- An independent contractor
- A common-law employee
- A statutory employee
- A statutory nonemployee

In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

It is critical that you, the employer, correctly determine whether the individuals providing services are employees or independent contractors. Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors.

Caution: If you incorrectly classify an employee as an independent contractor, you can be held liable for employment taxes for that worker, plus a penalty.

Who is an Independent Contractor?
A general rule is that you, the payer, have the ***right to control or direct only the result of the work*** done by an independent contractor, and ***not the means and methods of accomplishing the result***

> **Example:** Vera Elm, an electrician, submitted a job estimate to a housing complex for electrical work at $16 per hour for 400 hours. She is to receive $1,280 every 2 weeks for the next 10 weeks. This is not considered payment by the hour. Even if she works more or less than 400 hours to complete the work, Vera Elm will receive $6,400. She also performs additional electrical installations under contracts with other companies, that she obtained through advertisements. Vera is an **independent contractor**.

How should I report payments made to independent contractors?

You may be required to file information returns to report certain types of payments made to independent contractors during the year. For example, you must file Form 1099-MISC, Miscellaneous Income, to report payments of $600 or more to persons not treated as employees (e.g. independent contractors) for services performed for your trade or business. For details about filing Form 1099 and for information about required electronic or magnetic media filing, refer to information returns.

Who is a Common-Law Employee (Employee)?
Under common-law rules, anyone who performs services for you is your employee if you can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed.

To determine whether an individual is an employee or independent contractor under the common law, the relationship of the worker and the business must be examined. All evidence of control and independence must be considered. In an employee-independent contractor determination, all information that provides evidence of the degree of control and degree of independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties. Refer to Publication 15-A, Employer's Supplemental Tax Guide for additional information.

Who is an Employee?
A general rule is that anyone who performs services for you is your employee***if you can control what will be done and how it will be done***

> **Example:** Donna Lee is a salesperson employed on a full-time basis by Bob Blue, an auto dealer. She works 6 days a week, and is on duty in Bob's showroom on certain assigned days and times. She appraises trade-ins, but her appraisals are subject to the sales manager's approval. Lists of prospective customers belong to the dealer. She has to develop leads and

report results to the sales manager. Because of her experience, she requires only minimal assistance in closing and financing sales and in other phases of her work. She is paid a commission and is eligible for prizes and bonuses offered by Bob. Bob also pays the cost of health insurance and group-term life insurance for Donna. Donna is an employee of Bob Blue.

Statutory Employees
If workers are independent contractors under the common law rules, such workers may nevertheless be treated as employees by statute (statutory employees) for certain employment tax purposes if they fall within any one of the following four categories and meet the three conditions described under **Social security and Medicare taxes** , below.

- A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.
- A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
- An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name, if you also furnish specifications for the work to be done.
- A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer s business operation. The work performed for you must be the salesperson s principal business activity. Refer to the **Salesperson** section located in **Publication 15-A**, Employer s Supplemental Tax Guide for additional information.

Statutory Nonemployees
There are two categories of statutory nonemployees: ***direct sellers*** and ***licensed real estate agents.*** They are treated as self-employed for all Federal tax purposes, including income and employment taxes, if:

1. Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked and
2. Their services are performed under a written contract providing that they will not be treated as employees for Federal tax purposes.

Refer to information on **Direct Sellers** located in Publication 15-A, Employer s Supplemental Tax Guide for additional information.

Misclassification of Employees

Consequences of treating an employee as an independent contractor. If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker. See Internal Revenue Code section 3509 for additional information.

Resources

- Tax Topic 762 Basic Information
  To determine whether a worker is an independent contractor or an employee, you must examine the relationship between the worker and the business. All evidence of control and independence in this relationship should be considered. The facts that provide this evidence fall into three categories Behavioral Control, Financial Control, and the Type of Relationship itself.
- Publication 1976, Section 530 Employment Tax Relief Requirements(PDF)
  Section 530 provides businesses with relief from Federal employment tax obligations if certain requirements are met.
- IRS Internal Training: Employee/Independent Contractor (PDF)
  This manual provides you with the tools to make correct determinations of worker classifications. It discusses facts that may indicate the existence of an independent contractor or an employer-employee relationship. This training manual is a guide and is not legally binding. If you would like the IRS to make the determination of worker status, please file IRS Form SS-8.
- Form SS-8 (PDF)
  Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding
- Publication 15-A
  The Employer's Supplemental Tax Guide has detailed guidance including information for specific industries.
- Publication 15-B
  The Employer's Tax Guide to Fringe Benefits supplements Circular E (Pub. 15), Employer's Tax Guide, and Publication 15-A, Employer's Supplemental Tax Guide. It contains specialized and detailed information on the employment tax treatment of fringe benefits.

Internal Revenue Service
United States Department of the Treasury

Publication 15-A - Main Contents

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1. Who Are Employees?

Before you can know how to treat payments that you make to workers for services, you must first know the business relationship that exists between you and the person performing the services. The person performing the services may be:

- An independent contractor,
- A common-law employee,
- A statutory employee, or
- A statutory nonemployee.

This discussion explains these four categories. A later discussion, *Employee or Independent Contractor?* (section 2), points out the differences between an independent contractor and an employee and gives examples from various types of occupations. If an individual who works for you is not an employee under the common-law rules (see section 2), you generally do not have to withhold federal income tax from that individual's pay. However, in some cases you may be required to withhold under backup withholding requirements on these payments. See Publication 15 (Circular E) for information on backup withholding.

Independent Contractors

People such as lawyers, contractors, subcontractors, public stenographers, and auctioneers who follow an independent trade, business, or profession in which they offer their services to the public, are generally not employees. However, whether such people are employees or independent contractors depends on the facts in each case. The general rule is that an individual is an independent contractor if you, the person for whom the services are performed, have the right to control or direct only the result of the work and not the means and methods of accomplishing the result.

Common-Law Employees

Under common-law rules, anyone who performs services for you is your employee if you have the right to control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed. For a discussion of facts that indicate whether an individual providing services is an independent contractor or employee, see *Employee or Independent Contractor?* (section 2).

If you have an employer-employee relationship, it makes no difference how it is labeled. The substance of the relationship, not the label, governs the worker's status. Nor does it matter whether the individual is employed full time or part time.

For employment tax purposes, no distinction is made between classes of employees. Superintendents, managers, and other supervisory personnel are all employees. An officer of a corporation is generally an employee; however, an officer who performs no services or only minor services, and neither receives nor is entitled to receive any pay, is not considered an employee. A director of a corporation is not an employee with respect to services performed as a director.

You generally have to withhold and pay income, social security, and Medicare taxes on wages that you pay to common-law employees. However, the wages of certain employees may be exempt from one or more of these taxes. See *Employees of Exempt Organizations* (section 3) and *Religious Exemptions* (section 4).

Leased employees. Under certain circumstances, a corporation furnishing workers to various professional people and firms is the employer of those workers for employment tax purposes. For example, a professional service corporation may provide the services of secretaries, nurses, and other similarly trained workers to its subscribers.

The service corporation enters into contracts with the subscribers under which the subscribers specify the services to be provided and a fee is paid to the service corporation for each individual furnished. The service corporation has the right to control and direct the worker's services for the subscriber, including the right to discharge or reassign the worker. The service corporation hires the workers, controls the payment of their wages, provides them with unemployment insurance and other benefits, and is the employer for employment tax purposes. For information on employee leasing as it relates to pension plan qualification requirements, see *Leased employee* in Publication 560, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans).

Additional information. For more information about the treatment of special types of employment, the treatment of special types of payments, and similar subjects, refer to Publication 15 (Circular E); or Publication 51 (Circular A) for agricultural employers.

Statutory Employees

If workers are independent contractors under the common law rules, such workers may nevertheless be treated as employees by statute ("statutory employees") for certain employment tax purposes if they fall within **any**one of the following four categories **and** meet the three conditions described under *Social security and Medicare taxes*, below.

1. A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.
2. A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
3. An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name, if you also furnish specifications for the work to be done.
4. A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed for you must be the salesperson's principal business activity. See *Salesperson* in section 2.

Social security and Medicare taxes. Withhold social security and Medicare taxes from the wages of statutory employees if **all three** of the following conditions apply.

- The service contract states or implies that substantially all the services are to be performed personally by them.
- They do not have a substantial investment in the equipment and property used to perform the services (other than an investment in transportation facilities).
- The services are performed on a continuing basis for the same payer.

Federal unemployment (FUTA) tax. For FUTA tax, the term "employee" means the same as it does for social security and Medicare taxes, except that it does not include statutory employees in categories 2 and 3 above. Thus, any individual who is an employee under category 1 or 4 is also an employee for FUTA tax purposes and subject to FUTA tax.

Income tax. Do not withhold federal income tax from the wages of statutory employees.

Reporting payments to statutory employees. Furnish Form W-2 to a statutory employee, and check "Statutory employee" in box 13. Show your payments to the employee as "other compensation" in box 1. Also, show social security wages in box 3, social security tax withheld in box 4, Medicare wages in box 5, and Medicare tax withheld in box 6. The statutory employee can deduct his or her trade or business expenses from the payments shown on Form W-2. He or she reports earnings as a statutory employee on line 1 of Schedule C or C-EZ (Form 1040). (A statutory employee's business expenses are deductible on Schedule C or C-EZ (Form 1040) and are not subject to the reduction by 2% of his or her adjusted gross income that applies to common-law employees.)

Statutory Nonemployees

There are three categories of statutory nonemployees: direct sellers, licensed real estate agents, and certain companion sitters. Direct sellers and licensed real estate agents are treated as self-employed for all federal tax purposes, including income and employment taxes, if:

- Substantially all payments for their services as direct sellers or real estate agents are directly related to sales or other output, rather than to the number of hours worked and
- Their services are performed under a written contract providing that they will not be treated as employees for federal tax purposes.

Direct sellers. Direct sellers include persons falling within any of the following three groups.

1. Persons engaged in selling (or soliciting the sale of) consumer products in the home or place of business other than in a permanent retail establishment.
2. Persons engaged in selling (or soliciting the sale of) consumer products to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis prescribed by regulations, for resale in the home or at a place of business other than in a permanent retail establishment.
3. Persons engaged in the trade or business of delivering or distributing newspapers or shopping news (including any services directly related to such delivery or distribution).

Direct selling includes activities of individuals who attempt to increase direct sales activities of their direct sellers and who earn income based on the productivity of their direct sellers. Such activities include providing motivation and encouragement; imparting skills, knowledge, or experience; and recruiting. For more information on direct sellers, see Publication 911, Direct Sellers.

Licensed real estate agents. This category includes individuals engaged in appraisal activities for real estate sales if they earn income based on sales or other output.

Companion sitters. Companion sitters are individuals who furnish personal attendance, companionship, or household care services to children or to individuals who are elderly or disabled. A person engaged in the trade or business of putting the sitters in touch with individuals who wish to employ them (that is, a companion sitting placement service) will not be treated as the employer of the sitters if that person does not receive or pay the salary or wages of the sitters and is compensated by the sitters or the persons who employ them on a fee basis. Companion sitters who are not employees of a companion sitting placement service are generally treated as self-employed for all federal tax purposes.

Misclassification of Employees

Consequences of treating an employee as an independent contractor. If you classify an employee as an independent contractor and you have **no reasonable basis** for doing so, you may be held liable for employment taxes for that worker (the relief provisions, discussed below, will not apply). See Internal Revenue Code section 3509 for more information.

Relief provisions. If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker. To get this relief, you must file all required federal information returns on a basis consistent with your treatment of the worker. You (or your predecessor) must not have treated any worker holding a substantially similar position as an employee for any periods beginning after 1977.

Technical service specialists. This relief provision does not apply for a technical services specialist you provide to another business under an arrangement between you and the other business. A technical service specialist is an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work.

This limit on the application of the rule does not affect the determination of whether such workers are employees under the common-law rules. The common-law rules control whether the specialist is treated as an employee or an independent contractor. However, if you directly contract with a technical service specialist to provide services for your business and not for another business, you may still be entitled to the relief provision.

2. Employee or Independent Contractor?

An employer must generally withhold federal income taxes, withhold and pay social security and Medicare taxes, and pay unemployment tax on wages paid to an employee. An employer does not generally have to withhold or pay any taxes on payments to independent contractors.

Common-Law Rules

To determine whether an individual is an employee or an independent contractor under the common law, the relationship of the worker and the business must be examined. In any employee-independent contractor determination, all information that provides evidence of the degree of control and the degree of independence must be considered.

Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties. These facts are discussed below.

Behavioral control. Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include the type and degree of:

Instructions that the business gives to the worker. An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work.

- When and where to do the work.
- What tools or equipment to use.
- What workers to hire or to assist with the work.
- Where to purchase supplies and services.
- What work must be performed by a specified individual.
- What order or sequence to follow.

The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.

Training that the business gives to the worker. An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

Financial control. Facts that show whether the business has a right to control the business aspects of the worker's job include:

The extent to which the worker has unreimbursed business expenses. Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services that they perform for their business.

The extent of the worker's investment. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.

The extent to which the worker makes his or her services available to the relevant market. An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.

How the business pays the worker. An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.

The extent to which the worker can realize a profit or loss. An independent contractor can make a profit or loss.

Type of relationship. Facts that show the parties' type of relationship include:

- Written contracts describing the relationship the parties intended to create.
- Whether or not the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.
- The permanency of the relationship. If you engage a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that your intent was to create an employer-employee relationship.
- The extent to which services performed by the worker are a key aspect of the regular business of the company.If a worker provides services that are a key aspect of your regular business activity, it is more likely that you will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

IRS help. If you want the IRS to determine whether or not a worker is an employee, file Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, with the IRS.

Industry Examples

The following examples may help you properly classify your workers:

Building and Construction Industry

Example 1.

Jerry Jones has an agreement with Wilma White to supervise the remodeling of her house. She did not advance funds to help him carry on the work. She makes direct payments to the suppliers for all necessary materials. She carries liability and workers' compensation insurance covering Jerry and others that he engaged to assist him. She pays them an hourly rate and exercises almost constant supervision over the work. Jerry is not free to transfer his assistants to other jobs. He may not work on other jobs while working for Wilma. He assumes no responsibility to complete the work and will incur no contractual liability if he fails to do so. He and his assistants perform personal services for hourly wages. Jerry Jones and his assistants are employees of Wilma White.

Example 2.

Milton Manning, an experienced tilesetter, orally agreed with a corporation to perform full-time services at construction sites. He uses his own tools and performs services in the order designated by the corporation and according to its specifications. The corporation supplies all materials, makes frequent inspections of his work, pays him on a piecework basis, and carries workers' compensation insurance on him. He does not have a place of business or hold himself out to perform similar services for others. Either party can end the services at any time. Milton Manning is an employee of the corporation.

Example 3.

Wallace Black agreed with the Sawdust Co. to supply the construction labor for a group of houses. The company agreed to pay all construction costs. However, he supplies all the tools and equipment. He performs personal services as a carpenter and mechanic for an hourly wage. He also acts as superintendent and foreman and engages other individuals to assist him. The company has the right to select, approve, or discharge any helper. A company representative makes frequent inspections of the construction site. When a house is finished, Wallace is paid a certain percentage of its costs. He is not responsible for faults, defects of construction, or wasteful operation. At the end of each week, he presents the company with a statement of the amount that he has spent, including the payroll. The company gives him a check for that amount from which he pays the assistants, although he is not personally liable for their wages. Wallace Black and his assistants are employees of the Sawdust Co.

Example 4.

Bill Plum contracted with Elm Corporation to complete the roofing on a housing complex. A signed contract established a flat amount for the services rendered by Bill Plum. Bill is a licensed roofer and carries workers' compensation and liability insurance under the business name, Plum Roofing. He hires his own roofers who are treated as employees for federal employment tax purposes. If there is a problem with the roofing work, Plum Roofing is responsible for paying for any repairs. Bill Plum, doing business as Plum Roofing, is an independent contractor.

Example 5.

Vera Elm, an electrician, submitted a job estimate to a housing complex for electrical work at $16 per hour for 400 hours. She is to receive $1,280 every 2 weeks for the next 10 weeks. This is not considered payment by the hour. Even if she works more or less than 400 hours to complete the work, Vera Elm will receive $6,400. She also performs additional electrical installations under contracts with other companies, that she obtained through advertisements. Vera is an independent contractor.

For more information about employment taxes in the building and construction industry, visit the IRS website at www.irs.govand type "Construction" in the search box.

Trucking Industry

Example.

Rose Trucking contracts to deliver material for Forest, Inc., at $140 per ton. Rose Trucking is not paid for any articles that are not delivered. At times, Jan Rose, who operates as Rose Trucking, may also lease another truck and engage a driver to complete the contract. All operating expenses, including insurance coverage, are paid by Jan Rose. All equipment is owned or rented by Jan and she is responsible for all maintenance. None of the drivers are provided by Forest, Inc., Jan Rose, operating as Rose Trucking, is an independent contractor.

Computer Industry

Example.

Steve Smith, a computer programmer, is laid off when Megabyte, Inc., downsizes. Megabyte agrees to pay Steve a flat amount to complete a one-time project to create a certain product. It is not clear how long that it will take to complete the project, and Steve is not guaranteed any minimum payment for the hours spent on the program. Megabyte provides Steve with no instructions beyond the specifications for the product itself. Steve and Megabyte have a written contract, which provides that Steve is considered to be an independent contractor, is required to pay federal and state taxes, and receives no benefits from Megabyte. Megabyte will file a Form 1099-MISC. Steve does the work on a new high-end computer that cost him $7,000. Steve works at home and is not expected or allowed to attend meetings of the software development group. Steve is an independent contractor.

Automobile Industry

Example 1.

Donna Lee is a salesperson employed on a full-time basis by Bob Blue, an auto dealer. She works six days a week and is on duty in Bob's showroom on certain assigned days and times. She appraises trade-ins, but her appraisals are subject to the sales manager's approval. Lists of prospective customers belong to the dealer. She is required to develop leads and report results to the sales manager. Because of her

experience, she requires only minimal assistance in closing and financing sales and in other phases of her work. She is paid a commission and is eligible for prizes and bonuses offered by Bob. Bob also pays the cost of health insurance and group-term life insurance for Donna. Donna is an employee of Bob Blue.

Example 2.

Sam Sparks performs auto repair services in the repair department of an auto sales company. He works regular hours and is paid on a percentage basis. He has no investment in the repair department. The sales company supplies all facilities, repair parts, and supplies; issues instructions on the amounts to be charged, parts to be used, and the time for completion of each job; and checks all estimates and repair orders. Sam is an employee of the sales company.

Example 3.

An auto sales agency furnishes space for Helen Bach to perform auto repair services. She provides her own tools, equipment, and supplies. She seeks out business from insurance adjusters and other individuals and does all of the body and paint work that comes to the agency. She hires and discharges her own helpers, determines her own and her helpers' working hours, quotes prices for repair work, makes all necessary adjustments, assumes all losses from uncollectible accounts, and receives, as compensation for her services, a large percentage of the gross collections from the auto repair shop. Helen is an independent contractor and the helpers are her employees.

Attorney

Example.

Donna Yuma is a sole practitioner who rents office space and pays for the following items: telephone, computer, on-line legal research linkup, fax machine, and photocopier. Donna buys office supplies and pays bar dues and membership dues for three other professional organizations. Donna has a part-time receptionist who also does the bookkeeping. She pays the receptionist, withholds and pays federal and state employment taxes, and files a Form W-2 each year. For the past 2 years, Donna has had only three clients, corporations with which there have been long-standing relationships. Donna charges the corporations an hourly rate for her services, sending monthly bills detailing the work performed for the prior month. The bills include charges for long distance calls, on-line research time, fax charges, photocopies, postage, and travel, costs for which the corporations have agreed to reimburse her. Donna is an independent contractor.

Taxicab Driver

Example.

Tom Spruce rents a cab from Taft Cab Co. for $150 per day. He pays the costs of maintaining and operating the cab. Tom Spruce keeps all fares that he receives from customers. Although he receives the benefit of Taft's two-way radio communication equipment, dispatcher, and advertising, these items benefit both Taft and Tom Spruce. Tom Spruce is an independent contractor.

Salesperson

To determine whether salespersons are employees under the usual **common-law**rules, you must evaluate each individual case. If a salesperson who works for you does not meet the tests for a common-law employee, discussed earlier, you do not have to withhold federal income tax from his or her pay (see *Statutory Employees* in section 1). However, even if a salesperson is not an employee under the usual common-law rules, his or her pay may still be subject to social security, Medicare, and FUTA taxes.

To determine whether a salesperson is an employee for social security, Medicare, and FUTA tax purposes, the salesperson must meet **all eight** elements of the statutory employee test. A salesperson is a statutory employee for social security, Medicare, and FUTA tax purposes if he or she:

1. Works full time for one person or company except, possibly, for sideline sales activities on behalf of some other person,
2. Sells on behalf of, and turns his or her orders over to, the person or company for which he or she works,
3. Sells to wholesalers, retailers, contractors, or operators of hotels, restaurants, or similar establishments,
4. Sells merchandise for resale, or supplies for use in the customer's business,
5. Agrees to do substantially all of this work personally,
6. Has no substantial investment in the facilities used to do the work, other than in facilities for transportation,
7. Maintains a continuing relationship with the person or company for which he or she works, and
8. Is **not** an employee under common-law rules.

3. Employees of Exempt Organizations

Many nonprofit organizations are exempt from federal income tax. Although they do not have to pay federal income tax themselves, they must still withhold federal income tax from the pay of their employees. However, there are special social security, Medicare, and federal unemployment (FUTA) tax rules that apply to the wages that they pay their employees.

Section 501(c)(3) organizations. Nonprofit organizations that are exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code include any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, fostering national or international amateur sports competition, or for the prevention of cruelty to children or animals. These organizations are usually corporations and are exempt from federal income tax under section 501(a).

Social security and Medicare taxes. Wages paid to employees of section 501(c)(3) organizations are subject to social security and Medicare taxes unless one of the following situations applies.

- The organization pays an employee less than $100 in a calendar year.
- The organization is a church or church-controlled organization opposed for religious reasons to the payment of social security and Medicare taxes and has filed Form 8274, Certification by Churches and Qualified Church-Controlled Organizations Electing Exemption From Employer Social Security and Medicare Taxes, to elect exemption from social security and Medicare taxes. The organization must have filed for exemption before the first date on which a quarterly employment tax return (Form 941) would otherwise be due.

An employee of a church or church-controlled organization that is exempt from social security and Medicare taxes must pay self-employment tax if the employee is paid $108.28 or more in a year. However, an employee who is a member of a qualified religious sect can apply for an exemption from the self-employment tax by filing Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits. See *Members of recognized religious sects opposed to insurance* in section 4.

Federal unemployment tax. An organization that is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code is also exempt from the federal unemployment (FUTA) tax. This exemption cannot be waived.

Note.

An organization wholly owned by a state or its political subdivision should contact the appropriate state official for information about reporting and getting social security and Medicare coverage for its employees.

Other than section 501(c)(3) organizations. Nonprofit organizations that are not section 501(c)(3) organizations may also be exempt from federal income tax under section 501(a) or section 521. However, these organizations are not exempt from withholding federal income, social security, or Medicare tax from their employees' pay, or from paying FUTA tax. Two special rules for social security, Medicare, and FUTA taxes apply.

1. If an employee is paid less than $100 during a calendar year, his or her wages are not subject to social security and Medicare taxes.
2. If an employee is paid less than $50 in a calendar quarter, his or her wages are not subject to FUTA tax for the quarter.

The above rules do not apply to employees who work for pension plans and other similar organizations described in section 401(a).

4. Religious Exemptions

Special rules apply to the treatment of ministers for social security purposes. An exemption from social security is available for ministers and certain other religious workers and members of certain recognized religious sects. For more information on getting an exemption, see Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers.

Ministers. Ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination. They are given the authority to conduct religious worship, perform sacerdotal functions, and administer ordinances and sacraments according to the prescribed tenets and practices of that religious organization.

A minister who performs services for you subject to your will and control is your employee. The common-law rules discussed in sections 1 and 2 should be applied to determine whether a minister is your employee or is self-employed. The earnings of a minister are not subject to federal income, social security, and Medicare tax withholding. However, the earnings as reported on the minister's Form 1040 are subject to self-employment tax and federal income tax. You do not withhold these taxes from wages earned by a minister, but you may agree with the minister to voluntarily withhold tax to cover the minister's liability for self-employment tax and federal income tax.

Form W-2. If your employee is an ordained minister, report all taxable compensation as wages in box 1 on Form W-2. Include in this amount expense allowances or reimbursements paid under a nonaccountable plan, discussed in section 5 of Publication 15 (Circular E). Do not include a parsonage allowance (excludable housing allowance) in this amount. You may report a parsonage or rental allowance (housing allowance), utilities allowance, and the rental value of housing provided in a separate statement or in box 14 on Form W-2. Do not show on Form W-2 or Form 941 any amount as social security or Medicare wages, or any withholding for social security or Medicare taxes. If you withheld tax from the minister under a voluntary agreement, this amount should be shown in box 2 on Form W-2 as federal income tax withheld. For more information on ministers, see Publication 517.

Exemptions for ministers and others. Certain ordained ministers, Christian Science practitioners, and members of religious orders who have not taken a vow of poverty, who are subject to self-employment tax, may apply to exempt their earnings from the tax on religious grounds. The application must be based on conscientious opposition to public insurance because of personal religious considerations. The exemption applies only to qualified services performed for the religious organization. See Rev. Proc. 91-20, 1991-1 C.B. 524, for guidelines to determine whether an organization is a religious order or whether an individual is a member of a religious order.

To apply for the exemption, the employee should file Form 4361, Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners. See Publication 517 for more information about claiming an exemption from self-employment tax using Form 4361.

Members of recognized religious sects opposed to insurance. If you belong to a recognized religious sect or to a division of such sect that is opposed to insurance, you may qualify for an exemption from the self-employment tax. To qualify, you must be conscientiously opposed to accepting the benefits of any public or private insurance that makes payments because of death, disability, old age, or retirement, or makes payments toward the cost of, or provides services for, medical care (including social security and Medicare benefits). If you buy a retirement annuity from an insurance company, you will not be eligible for this exemption. Religious opposition based on the teachings of the sect is the only legal basis for the exemption. In addition, your religious sect (or division) must have existed since December 31, 1950.

Self-employed. If you are self-employed and a member of a recognized religious sect opposed to insurance, you can apply for exemption by filing Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits, and waive all social security benefits.

A bill for an act

relating to retirement; general employees retirement plan of the Public Employees Retirement Association; authorizing the purchase of service credit by certain public golf course employees.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. **PERA-GENERAL; PUBLIC GOLF COURSE EMPLOYEE SERVICE CREDIT PURCHASE .**

(a) An eligible person described in paragraph (b) is entitled to purchase allowable service credit from the general employees retirement plan of the Public Employees Retirement Association for the period of employment by the city of Anoka at the Greenhaven Golf Course that qualified as employment by a public employee under Minnesota Statutes, section 353.01, subdivisions 2, 2a, and 2b, that was not previously credited by the retirement plan.

(b) An eligible person is a person who:

(1) was born on July 18, 1954;

(2) was first employed by the city of Anoka at the Greenhaven Golf Course as a part-time employee in 1978;

(3) was incorrectly characterized as an independent contractor by the city of Anoka during the period 1982-1998, although the person was provided health insurance and other employment recognition during portions of that period; and

(4) became a member of the general employees retirement plan of the Public Employees Retirement Association in 1998.

(c) The eligible person described in paragraph (b) must apply with the executive director of the Public Employees Retirement Association to make the service credit

purchase under this section. The application must be in writing and must include all necessary documentation of the applicability of this section and any other relevant information that the executive director may require.

(d) Allowable service credit under Minnesota Statutes, section 353.01, subdivision 16, must be granted by the general employees retirement plan of the Public Employees Retirement Association to the account of the eligible person upon the receipt of the prior service credit purchase payment amount required under Minnesota Statutes, section 356.551.

(e) Of the prior service credit purchase payment amount under Minnesota Statutes, section 356.551, the eligible person must pay an amount equal to the employee contribution rate or rates in effect during the uncredited employment period applied to the actual salary rates in effect during the period, plus annual compound interest at the rate of 8.5 percent from the date the member contribution payment should have been made if made in a timely fashion until the date on which the contribution is actually made. If the equivalent member contribution payment, plus interest, is made, the city of Anoka shall pay the balance of the total prior service credit purchase payment amount under Minnesota Statutes, section 356.551, within 60 days of notification by the executive director of the Public Employees Retirement Association of the member contribution equivalent payment.

(f) Authority for an eligible person to make a prior service credit purchase under this section expires on June 30, 2007.

(g) If the city of Anoka fails to pay its portion of the prior service credit purchase payment amount under paragraph (e), the executive director of the Public Employees Retirement Association must notify the commissioners of finance and revenue of that fact and the commissioners shall order the deduction of the required payment amount from the next subsequent payment of any state aid to the city of Anoka and be transmitted to the general employees retirement fund.

Sec. 2. **EFFECTIVE DATE.**

Section 1 is effective on the day following final enactment.