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FILE NO. 91-032

PENSIONS:
Medicare Coverage of Teachers
in Annexed or Consolidated
School Districts

Michael L. Mory
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Dear Mr. Mory:

I have your letter wherein you inquire whether, under Illinois law, public school teachers who entered service on or before March 31, 1986, in school districts which are subsequently involved in consolidations, mergers or annexations, should be considered continuing employees of a political subdivision employer, for purposes of the continuing employment exception specified in subsection 3121(u) of the Internal Revenue Code (26 U.S.C. § 3121(u)), as interpreted in Revenue

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Ruling 86-88, and so remain exempt from paying Medicare tax on their income. For the reasons hereinafter stated, it is my opinion that teachers in such circumstances meet the continuing employment exception set forth therein.

Pursuant to the enactment of section 13205 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (PL 99-272, 100 Stat. 82), newly hired State and local governmental employees who are not covered by Social Security are mandatorily covered by Medicare. The earnings of such employees are subject to the Medicare tax at the rate of 1.45 percent. The tax does not apply, however, to persons in a continuing employment relationship with a governmental entity which commenced prior to April 1, 1986. Under subsection 3121(u)(2)(C) of the Internal Revenue Code, this continuing employment exception applies when:

> " * * *
>
> (ii) such service is performed by an individual-
>
> (I) who was performing substantial and regular service for remuneration for that employer before April 1, 1986,
>
> (II) who is a bona fide employee of that employer on March 31, 1986, and
>
> (III) whose employment relationship with that employer has not been terminated after March 31, 1986."

Further, subsection 3121(u)(2)(D) provides:

> "(D) - For purposes of subparagraph (C), under regulations -

> "(i) All agencies and instrumentalities of a State * * * shall be treated as a single employer.
>
> (ii) All agencies and instrumentalities of a political subdivision of a State (as so defined) shall be treated as a single employer * * *"

Revenue Ruling 86-88 was issued to provide guidance, inter alia, in applying the changes effected by section 13205 of the Consolidated Omnibus Budget Reconciliation Act of 1985. In its examples of how the continuing employment exception would be applied in various circumstances, the Revenue Ruling indicates that employee transfers from one political subdivision employer to another employer of the same political subdivision are covered by the exception. Transfers from one political subdivision to another, however, do not constitute continuing employment, for purposes of subsection 3121(u)(2)(C) of the Internal Revenue Code, and an employee becomes liable for payment of Medicare taxes upon the termination of employment with one subdivision and the commencement of services for another.

In recent years, a number of school districts in Illinois have engaged in consolidations (e.g., District A and District B combine to create District C) or annexations (e.g., District D annexes District E, with the enlarged District D continuing), which have prompted questions concerning the continuing employment status of teachers in the affected

districts. The issue is whether a teacher who continues in service with the consolidated or enlarged school district is, in essence, continuing in service with his prior employer, or commencing service with a new employer. The documents enclosed with your letter indicate that your agency, as well as counsel for some of the school districts, have contacted the Internal Revenue Service (IRS) and the Social Security Administration in an effort to resolve this issue, but no definite conclusion has been reached. According to a letter from IRS Assistant Chief Counsel Jerry E. Holmes, dated February 22, 1990, the status of these employees as continuing employees depends upon whether the school districts resulting from consolidations or annexations constitute independent political subdivisions for employment purposes under Illinois law. It is my opinion that a consolidated or annexing school district, under Illinois law, is not an employer independent from the districts which existed prior to the consolidation or annexation.

While school districts have some characteristics of independent political subdivisions, the Constitution specifically provides that they are not units of local government (Ill. Const. 1970, art. VII, sec. 1), and State laws control teacher contractual continued service, particularly in the case of consolidation or annexation. On November 29, 1990, the General Assembly overrode the Governor's veto to enact Public Act 86-1441. Among other changes, the Act added new section

10-21.12 to the School Code (Ill. Rev. Stat. 1990 Supp., ch. 122, par. 10-21.12), which provides:

> "Sec. 10-21.12. Transfer of teachers. The employment of a teacher transferred from one board or administrative agent to the control of a new or different board or administrative agent shall be considered continuous employment if such transfer of employment occurred by reason of any of the following events:
>
> (1) a boundary change or the creation or reorganization of any school district pursuant to Article 7, 7A, 11A or 11B; or
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> (2) the deactivation or reactivation of any high school pursuant to section 10-22.22b; or
>
> (3) the creation, expansion, reduction or dissolution of a special education program pursuant to Section 10-22.31a; or
>
> (4) the creation, expansion, reduction, termination or dissolution of any joint agreement program operated by a regional superintendent, governing board, or other administrative agency or any program operated pursuant to an Intergovernmental Joint Agreement. <u>The changes made by this amendatory Act of 1990 are declaratory of existing law</u>."
>
> (Emphasis added.)

This new section clearly provides that teachers who are transferred from one board to another as the result of a reorganization (including consolidation or annexation) are to be considered, for purposes of Illinois law, as being continuously employed. (I note, in this regard, that prior to the enactment of Public Act 86-1441, section 11A-10 of the School Code (Ill. Rev. Stat. 1989, ch. 122, par. 11a-10) provided that teachers in districts which were combined to

create a community unit district were automatically transferred to the new board, so that the new board was obligated to fulfill the contracts as if the teachers had been continuously employed. Public Act 86-1441 added similar language to section 11B-9 of the Code (Ill. Rev. Stat. 1990 Supp., ch. 122, par. 11B-9), with respect to the combining of districts. Further, similar language is found in section 24-12 of the Code (Ill. Rev. Stat. 1990 Supp., ch. 122, par. 24-12), with respect to the transfer of a teaching position by reason of any district boundary change.)

In similar circumstances, the Federal Appellate court, in Board of Education of Muhlenberg Co. v. United States (6th Cir., 1990), 920 F.2d 370, held that teachers who were employed by the school districts which were consolidated to create the Muhlenberg County District were continuing employees of an employer whose name was changed. Like those of Illinois, Kentucky statutes required the consolidated district to honor the teaching contracts of the pre-existing districts.

When it enacted the amendment requiring newly hired State and local governmental employees to be covered by Medicare, Congress anticipated some problems in determining whether particular entities were separate employers. The report of the Committee on Ways and Means states:

" * * *

The Committee expects that cases in which the distinctions are more difficult to make will

> be judged according to the independence of the second employing unit from the first, as an employer." (H. R. Rept. No. 99-24, 99th Cong., 1st Sess. 26-27 (1985).)

The statutes of the State of Illinois, which are applicable to reorganized school districts, require the reorganized district to honor the contracts and continue the employment of teachers employed by the districts from which the reorganized district was created. The second employing unit has no independence, as an employer, from the first. Thus, under the Committee on Ways and Means' suggestion, employees of reorganized districts in Illinois should not be considered employees of a new political subdivision employer when they continue service for the reorganized school district.

Therefore, it is my opinion that teachers in a consolidated or annexed district should not be considered newly hired employees of the resulting entity, for purposes of section 3121 of the Internal Revenue Code, but rather should be covered by the "continuing employment" exception to coverage. Therefore, those teachers who began employment with a school district on or before March 31, 1986, and whose employment has subsequently been affected by a consolidation, annexation or other reorganization, should not thereby become liable for payment of the Medicare tax.

Respectfully yours,

ROLAND W. BURRIS
ATTORNEY GENERAL