

MEMO

TO: District Manager

FROM: Finance Manager

SUBJECT: EMPLOYMENT STATUS OF BOARD MEMBERS FOR IRS AND SOCIAL SECURITY

DATE: December 31, 2009

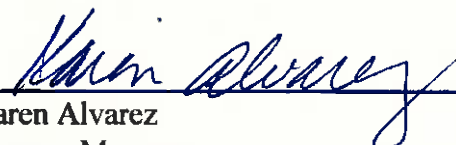
RECOMMENDATION:

It is recommended that the District Manager and Board of Directors review the attached "Draft for Discussion" pertaining to Employment Status of Board Members for IRS and social security dated September 4, 2009 as submitted by the District auditor, Charles Z. Fedak & Company, and approve the attached resolution which changes the employment status of Board Members to employees of the District for income tax and social security purposes to be effective as of January 1, 2010.

BACKGROUND:

Internal Revenue Code Section 3401(c) states "the term employee includes an officer, employee, or elected official of the United States, a State, or any political subdivision thereof." This code section governs whether the elected official is subject to and the District is obligated for income tax withholding. The federal government strongly argues that elected officials are also employees for purpose of social security taxation. Per Paul J. Kaymark, CPA, with Charles Z. Fedak & Company (the District's auditor), "The IRS believes that the per meeting or per month stipend pay is a payroll expense and subject to taxation and withholdings."

It is recommended that the Board of Directors review the attached "Draft for Discussion" pertaining to Employment Status of Board Members for IRS and social security dated September 4, 2009 as submitted by the District auditor, Charles Z. Fedak & Company, and approve the attached resolution which changes the employment status of Board Members to employees of the District for income tax and social security purposes to be effective as of January 1, 2010.



Karen Alvarez
Finance Manager

/KA

SAN LORENZO VALLEY WATER DISTRICT

RESOLUTION NO. (09-10)

SUBJECT: EMPLOYMENT STATUS OF BOARD MEMBERS FOR INCOME TAX AND SOCIAL SECURITY PURPOSE

WHEREAS, the District has received notification from it's independent auditor Charles Z. Fedak & Company regarding the employment status of Board Members for income tax and social security purposes; and

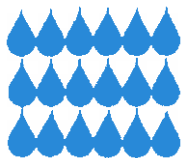
WHEREAS, the Internal Revenue Service states that elected officials should be treated as employees for income tax and social security purposes.

NOW, THEREFORE, BE IT RESOLVED by the Board of Directors of the San Lorenzo Valley Water District that effective January 1, 2010 elected officials of the San Lorenzo Valley Water District shall be treated as employees for income tax and social security purposes.

PASSED AND ADOPTED by the Board of Directors of the San Lorenzo Valley Water District, County of Santa Cruz, State of California, on the 7th day of January, 2010, by the following vote of the members thereof:

AYES:
NOES:
ABSTAIN:
ABSENT:

B. Barchi, District Secretary
San Lorenzo Valley Water District



Charles Z. Fedak, CPA, MBA
Paul J. Kaymark, CPA

Charles Z. Fedak & Company

Certified Public Accountants

An Accountancy Corporation

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September 4, 2009

Board of Directors

SUBJECT: Employment Status of Board Members for IRS and Social Security

SUMMARY: Elected officials should be treated as employees for income tax and social security purposes. They should be paid through the payroll system, use W-4's to control withholding and have income and withholding reported on W-2's at the end of the year. Currently 1099's are used to report Board Member compensation.

As employees, elected officials should be covered by social security taxes unless the agency is exempt from social security taxes and withholdings. Then the agency would determine if the Board Members are eligible for CalPERS or other retirement benefits to satisfy the IRS with non payment of social security taxes and withholdings. The criteria used to classify part time, seasonal and temporary employment does not translate well to the responsibilities of elected officials as well. Board Members elected since April 1, 1986 would also be subject to Medicare taxes.

DISCUSSION: In connection with a review of various issues relating to employee status for income and social security taxation it has been noted that elected officials employment status is defined by a specific IRS code section. Internal Revenue Code Section 3401(c) states "the term employee includes an officer, employee, or elected official of the United States, a State, or any political subdivision thereof." This code section governs whether the elected official is subject to and the District is obligated for income tax withholding. The federal government strongly argues that elected officials are also employees for purpose of Social Security Taxation. See below for excerpts from the Federal State Guide.

Federal State Guide Discussion of elected officials as employees – After noting that elected officials are clearly employees for income tax purposes the IRS and Social Security Administration's Federal State Guide (Publication 963) goes on to say that Social Security rules are governed by common law tests like those that we use to distinguish between employees and independent contractors. The Guide points out that elected officials are appropriately considered employees for a number of reasons:

"A critical factor for consideration in an employee status determination is whether there is a state constitution or statute establishing a position. State statutes should be reviewed to determine whether they establish enough control for the individual to be classified as an employee under the common law test. Statutes may state that a specific position is that of a public official, in which case there is likely to be a right to control sufficient to make the individual an employee. Statutes specify the duties of a public office and generally establish the officer's superiors and subordinates, if any. Statutes establish an official's term of office and sometimes the compensation. They may require that a public official take an oath of office. Statutes often establish general and specific penalties for dereliction of duty. For instance, members of Boards who are paid for each meeting they attend may face termination if they fail to attend a certain number of meetings.

Board of Directors

September 4, 2009

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A public official has authority to exercise the power of the government and does so as an agent and employee of the government. For this reason, the Supreme Court has held that public officials are employees. A public official performs a governmental duty exercised pursuant to a public law. Buckley v. Valeo, 424 U.S. 1, 141 (1975). A public office is a position created by law, holding a delegation of a portion of the sovereign powers of government to be exercised for the benefit of the public. Metcalf & Eddy v. Mitchel, 269 U.S. 514 (1926).

The Internal Revenue Code does not define the term "public official", but Regulation §1.1402(c)-2(b) gives the following examples with respect to the application of self-employment tax to public officials in specific circumstances: a mayor, member of a legislature, county commissioner, state or local judge, justice of the peace, county or city attorney, marshal, sheriff, constable, or a registrar of deeds. Other examples include tax collectors, tax assessors, road commissioners, and members of boards and commissions, such as school boards, utility districts, zoning boards, and boards of health.

As an example of the degree of control under which a public official works, consider city attorneys in State A. State statutes establish the position and define it as that of an officer and employee. These statutes define the duties of the position: the city attorney is required to direct all litigation in which the city is a party, including prosecuting criminal cases; to represent the city in all legal matters in which the city or a city officer is a party; to attend meetings of the commissioners, advise commissioners, mayors, etc., on all legal questions, and approve all contracts and legal documents. A city manager appoints, supervises and controls the work of the city attorney. The city attorney must take an oath of office. These facts show the importance of state statutes in establishing a right of direction and control of a public official to classify them as a common law employee.

For the same reason, elected officials are subject to a degree of control that typically makes them employees under the common law. Elected officials are responsible to the public, which has the power not to reelect them. Elected officials may also be subject to recall by the public or a superior official. Very few appointed officials have sufficient independence such that they will not be considered common-law employees. In any event, elected officials are employees for income tax withholding purposes under section 3401(c)."

Please let us know if you have any further questions.

Thank you,

Paul J. Kaymark, CPA
Charles Z. Fedak & Company, CPAs
An Accountancy Corporation