



# Monterey County

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## Board Report

Legistar File Number: 15-0958

September 01, 2015

**Introduced:** 8/24/2015

**Version:** 1

**Current Status:** Consent Agenda

**Matter Type:** General Agenda Item

Approve amending the County's Internal Revenue Code Section 125 Plan to add the Annual Leave/Vacation/PTO Buy Back Plan as described as Appendix C of the Plan effective September 1, 2015.

### RECOMMENDATION:

It is recommended that the Board of Supervisors:

Approve amending the County's Internal Revenue Code Section 125 Plan to add the Annual Leave/Vacation/PTO Buy Back Plan as described as Appendix C of the Plan effective September 1, 2015.

### SUMMARY/DISCUSSION:

It is proposed to amend the County's Section 125 Cafeteria Plan to include "vacation buy back" provisions as part of open enrollment in September of 2015. This amendment would require that employees make "irrevocable elections" concerning the amount of accrued leave they want the County to "buy back," starting on January 1, 2016. The reason for this amendment is to protect an employee's accrued leave from being taxed as being "constructively received." A copy of the proposed amendment, identified as "Appendix C - Annual Leave/ Vacation/PTO Buy Back Plan," is attached as Attachment A.

Tax law has a concept or doctrine known as "constructive receipt." Under this theory, income is considered "received" by an individual under certain circumstances, whether or not the individual actually "took" or used the income. A classic example is that of interest earned on savings accounts: the interest allocated is considered "received" by the taxpayer, even if that money continues to sit in the account and is not withdrawn and used.

The value of time available as "vacation buy back" for employees is subject to the "constructive receipt" doctrine, unless certain limitations are placed on the ability of the employee to use it. The tax consequences of an IRS determination of constructive receipt of this time would be adverse to all individual employees with this benefit, causing the employee to pay more taxes (and requiring the County to withhold more).

In order to avoid this situation, the Office of the Auditor-Controller and the CAO are recommending amending the County's Section 125 Cafeteria Plan. This amendment would require all eligible employees to make an irrevocable election (in the same manner as other elections for health insurance, etc. are required) with respect to the exercise of that employee's benefit to have the County "buy back" vacation time. The making of an "irrevocable election" has been accepted by the IRS as a "substantial limitation or restriction" on the taxpayer's availability to receive the benefit, thus taking it out of "constructive receipt."

This proposed action is being taken as part of the Auditor-Controller's obligation to ensure that

appropriate funds are withheld on taxable compensation, and does not represent a change in existing conditions of employment. This is because, while it is true that some measure of flexibility in the timing of exercising “vacation buy back” is reduced, the benefit itself is maintained. The only real difference is that the employee must think about the possibility of using that benefit, and decide whether or not to use it, during the open enrollment period prior to the actual year of use. As such, the employee cannot, on the spur of the moment, decide to exercise that benefit.

Discussions with employee units has been ongoing since late July 2015 that has helped explain the program that what is being proposed for Board consideration as part of this action. Some examples of different “vacation buy back” elections are included as Attachment B.

OTHER AGENCY INVOLVEMENT:

The Office of the Auditor-Controller, Human Resources Department and the CAO have worked together with the County Counsel’s Office and outside legal counsel to develop and review the proposed amendment.

FINANCING:

Approval of this should have only minor fiscal impacts since most bargaining units already contain provisions allowing employees to “cash out” a portion of their accrued leave. In 2014, employees cashed out a total of \$2,362,847 in accrued leave under this benefit. This amendment to the County’s Section 125 Cafeteria Plan does not change eligibility for cashing out vacation; rather it requires an employee who wishes to “cash out” accrued leave time to make this election during the annual open enrollment period. It is unknown what impact this restriction requiring employees to “plan ahead” will have on total “cash outs.”

Prepared and Approved by: Manuel T. González, Interim Human Resources Director, 3593

Attachments:

Attachment A: Appendix C - Annual Leave/ Vacation/PTO Buy Back Plan to The County of Monterey Section 125 Flexible Benefit Plan - Plan Amendment

Attachment B: Sample “buy back” election scenarios

  
\_\_\_\_\_  
Manny González, Assistant CAO

8/26/15  
\_\_\_\_\_  
Date

## APPENDIX C

### ANNUAL LEAVE/VACATION/PTO BUY BACK PLAN

**Effective Date of Resolution:** September 1, 2015

**Effective Date of Amendment:** January 1, 2016

By action of the Monterey County Board of Supervisors, the County of Monterey Section 125 Flexible Benefit Plan (Plan) is hereby amended as of the Effective Date specified above and to:

#### SECTION 1 – ESTABLISHMENT AND PURPOSE

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##### **1.1 Establishment and Purpose**

The County of Monterey (County) hereby establishes an Annual Leave/Vacation/PTO Buy Back Plan (Buy Back Plan) for the benefit of its eligible employees and pursuant to the terms and conditions contained in Internal Revenue Code Section 125 cafeteria plan regulations.

##### **1.2 Timing of Elections**

Employees who are eligible to participate in this Buy Back Plan must make the election to buy back a fixed amount of Annual Leave/Vacation/PTO during the election period immediately preceding the first day of the Plan Year in which the buy back will occur.

##### **1.3 Timing of Pay Outs**

Employees electing to buy back Annual Leave/Vacation/PTO may schedule distributions during the Plan Year subject to rules established by the County.

##### **1.4 Tax Treatment**

The full amount of Annual Leave/Vacation/PTO buy back will be treated as taxable income to the employee regardless of the amount actually used. Additionally, unused amounts as of the last day of the Plan Year will be forfeited unless cashed out pursuant to Section 1.6 below. Unused amounts cannot be carried over into the next Plan Year.

##### **1.5 IRC Section 125 Cafeteria Plan Elections**

Cafeteria plan rules require that all elections made under the Buy Back Plan must be between cash and qualified benefits, such as elections under this Annual Leave/Vacation/PTO Buy Back Plan.

##### **1.6 Cash Out Option**

IRS rules permit participants to elect a cash out option for unused buy back amounts at Plan Year end, so long as the cash out occurs prior to the last day of the Plan Year. Amounts cashed out will be treated as taxable income.

##### **1.7 Determining Value of Buy Back Amount**

The County will use the employee's then-current wage to determine the value of the buy back as of the date of payment.

##### **1.8 Non-Elective Annual Leave/Vacation/PTO**

Since this Buy Back Plan does not allow participants to purchase additional Annual Leave/Vacation/PTO amounts, all buy backs are considered to be made from non-elective Annual Leave/Vacation/PTO.

**1.9 Eligibility**

The County’s bargaining units specify participant eligibility and the amounts available for buy back, and other cash out rules. There are similar rules for non-bargained employees.

**1.10 Recordkeeping**

The County shall establish and maintain individual participant accounts for Annual Leave/Vacation/PTO buy back elections.

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**SECTION 2 – PLAN ADMINISTRATION**

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**2.1 Plan Administration**

The County shall be the Administrator of the Buy Back Plan. The County may appoint any person, including but not limited to a County employee or employees, or third party administrator (Appointee) to perform ministerial duties under this Buy Back Plan so long as the duties are consistent with the County’s underlying cafeteria plan document.

**2.2 Plan Procedures and Interpretation of Plan Provisions**

The County or its Appointee shall establish and maintain Buy Back Plan procedures, which are consistent with the County’s underlying cafeteria plan documents.

**2.3 Amendment and Termination**

The County reserves the right to amend or terminate the Annual Leave/Vacation/PTO Buy Back Plan at any time by providing written notice to all Buy Back Plan participants.

**2.4 Non-Assignment**

Pursuant to rules established by the County, a participant electing to buy back Annual Leave/Vacation/PTO time shall not be permitted to assign buy back amounts, whether as cash or as Annual Leave/Vacation/PTO to any other employee of the County.

**2.5 Constructive Receipt**

At no time shall the County operate this Buy Back Plan to result in deferred compensation to any participant.

All other provisions of this Plan remain in effect to the extent they are consistent with this Amendment.

IN WITNESS WHEREOF, the undersigned authorized representative of the Monterey County Board of Supervisors has executed this Amendment as evidence of its adoption by the Monterey County Board of Supervisors at its meeting of September \_\_\_\_, 2015.

For the Monterey County Board of Supervisors:

By: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

## **EXAMPLES FOR BUY BACK**

### **Scenario 1:**

In September, 2015, Open Enrollment employee elects 120 hours for Buy Back in 2016.

On December 31, 2015 it is determined that employee did not qualify for buy back, no tax impact for 2016 (no harm, no foul).

### **Scenario 2:**

In September, 2015, Open Enrollment employee elects 80 hours for Buy Back in 2016.

On December 31, 2015, it is determined that employee qualifies for buy back amounts elected.

Employee cashes out on March 31, 2016 in the amount of 80 hours.

Employee has fulfilled requirement (election). Employee pays taxes on cashed out amount, just as currently.

### **Scenario 3:**

In September, 2015, Open Enrollment employee elects 160 hours for Buy Back in 2016.

On December 31, 2015, it is determined that employee qualifies for buy back amounts elected.

Employee cashes out on April 15, 2016 in the amount of 40 hours.

Employee cashes out on November 15, 2016 in the amount of 40 hours.

Employee does not cash out balance of hours elected for buy back (80), A/C office will cash out balance of hours and pay employee on last check of 2016 to fulfill obligation of irrevocable election.

### **Scenario 4:**

In September, 2015, Open Enrollment employee elects NOT to Buy Back any hours in 2016.

In March, 2016, employee seeks to buy back hours.

Employee is denied cash out of hours because did not make election in Open Enrollment.