



County of Monterey

Board of Supervisors
Chambers
168 W. Alisal St., 1st Floor
Salinas, CA 93901

Board Report

File #: 15-0958, **Version:** 1

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allocated is considered "received" by the taxpayer, even if that money continues to sit in the account and is not withdrawn and used.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

Date