MEMORANDUM OF LAW

DATE: August 6, 1991

TO: F. D. Schlesinger, Clean Water Program Director

FROM: City Attorney

SUBJECT: Applicability of City of San Diego's Employee Benefits to San Diego Area Wastewater Management District Employees

In a memorandum dated June 24, 1991, you asked this office several questions concerning the possible continued participation by former City of San Diego employees in City of San Diego benefit programs, if they become employed by the proposed San Diego Area Wastewater Management District ("SAD"). You indicated that the SAD is projected to begin hiring employees on or about July 1, 1992. You also asked several questions concerning the City of San Diego's ability to provide benefit plan service for the SAD by contract. We shall answer each of your questions in the order asked.

QUESTION NO. 1

By virtue of becoming a separate entity, will the SAD employees be mandated into the Social Security System?

ANSWER

Participation in the Social Security System will not be mandatory for employees of the SAD if the employees are required to be members of a qualified public employee retirement system in accordance with 42 U.S.C. section 410(a)(7) and 26 U.S.C. section 3121(b)(7)(F). However, 26 U.S.C. section 3121(u) states that all state and local government employees hired on or after April 1, 1986, are subject to the medicare tax withholding provisions. The SAD will be a separate legal entity from the City of San Diego, therefore its employees will be subject to the medicare tax withholding provisions as new employees.

QUESTION NO. 2

How might the SAD employees continue under the City Employees' Retirement System ("CERS")? May we enter into a relationship in CERS similar to that enjoyed by San Diego Unified Port District ("Port District") employees?

ANSWER

Port District employees are general members of CERS under the authority of section 71 of the San Diego Unified Port District Act, Appendix I, California Harbors and Navigation Code. This section was amended in 1963 to permit the Port District to contract with any City,

within the Port District, which had a retirement system for retirement and disability benefits for all Port District employees. The Port District subsequently contracted with the City of San Diego for this service. Prior to that amendment, the original section 71 of the San Diego Unified Port District Act authorized only those former City employees "blanketed in" as employees of the Port District to continue as members of CERS. As currently drafted, the SAD enabling legislation (SB 1225) is silent on the entire issue of retirement benefits.

Article IX of the Charter of the City of San Diego, which contains the authority to establish CERS, makes no provision for the contracting of retirement services for employees of other governmental agencies, or for the continuation of retirement benefits for former members of CERS hired by other agencies, except that the Council is authorized, after a vote of the members of CERS to enter into a contract with the State of California for retirement services. That contingency is currently being explored by this office and the Retirement Administrator.

California Government Code section 6500 et seq. does provide a procedure whereby public agencies may exercise by cooperative action any existing power common to the contracting agencies. We are, however, unaware of the use of such joint powers agreements to provide retirement benefits. However, joint powers agreements have been used to provide workers' compensation benefits to a consortium of several small school districts. 56 Op. Att'y Gen. 411 (1973).

Based on the limiting language of Article IX of the Charter of the City of San Diego concerning CERS' ability to contract specifically with the State of California for retirement services, we believe it is not advisable for the SAD to contract with CERS for retirement services, absent an amendment to the SAD's enabling legislation.

QUESTION NO. 3

May the SAD establish a similar relationship with other City of San Diego benefit programs including, but not limited to, the Flexible Benefit Plan, the Management Bonus Plan, the 401(k) Plan, the Deferred Compensation Plan, and the Long Term Disability Plan?

ANSWER

As indicated above, there is no specific enabling legislation that authorizes such an arrangement. However, unlike the specific provisions of the Charter regulating CERS, there are no specific legal provisions contained in the Charter which limit the City's authority to manage a flexible benefit plan, a management bonus plan or a long term disability plan for employees of another agency by contract. Assuming that such an arrangement can be authorized by a joint powers agreement, the full funding of such benefit plans must be borne by the SAD. Another factor to consider is that an individual's flexible spending account may not be transferred from one employer to another. In other words, if an employee transfers from the City of San Diego to the SAD during a plan year, the

employee must close out one plan account and begin another as a new employee for the new employer. For example, funds remaining in an employee's dental/medical/vision reimbursable account cannot be transferred to the new employer's flexible spending account. The net result is that if the SAD establishes separate employee benefit plans, there is a possibility that these plans may be administered by the City of San Diego through a joint powers agreement.

The City of San Diego established its 401(k) Plan during a specific window period which was closed by Congress several years ago. A public agency is prohibited from maintaining a 401(k) plan unless it meets the grandfather provisions of 26 U.S.C. section 401(k). Therefore, the SAD will not be able to implement a 401(k) plan. An employee may, upon termination of employment with the City of San Diego, rollover his or her 401(k) account into an Individual Retirement Account (IRA) without suffering a taxable event.

The City of San Diego does not, itself, administer an Internal Revenue Code ("IRC") section 457 deferred compensation plan. The City's plan is administered by The Hartford. The SAD may establish a 457 plan with The Hartford or with another provider of deferred compensation plans, and if all requirements are met, a terminated City employee may transfer his or her account to the new SAD account without suffering a taxable event. However, a section 457 account may not be rolled over into an IRA upon termination of employment.

Although not mentioned in your memorandum, we believe it is necessary to address how a former City employee may transfer his or her Supplemental Pension and Savings Plan ("SPSP") account to a similar plan maintained by the SAD. Generally speaking, IRC section 402(a)(5) permits a distribution from a qualified defined contribution plan to be received by the distributee without recognition of taxable income as long as the distribution is contributed to another qualified plan within sixty (60) days of receipt. This is commonly referred to as a rollover or, more precisely, a plan-to-plan transfer. It is possible for the SAD to establish a qualified defined contribution plan similar to SPSP in order for former City employees to transfer their taxable employer contributions and interest earnings to such an account. Amounts of employee contributions included in the distribution may not be rolled over or transferred because that amount is received upon termination of employment from the City tax-free, as those contributions were made with after-tax dollars. It is also possible for the SAD to provide an employee with the same vesting schedule as the employee had with the City of San Diego.

QUESTION NO. 4

Is there any prohibition to the SAD contracting with the City of San Diego for other benefit and benefit related programs such as Workers' Compensation, Industrial Leave, Parkade discounts, and the Transportation

Incentive Program?

ANSWER

Once again, there are no specific legal prohibitions against the City of San Diego managing such types of programs for the SAD. In fact, as previously discussed, there is some authority for the use of a joint powers agreement to consolidate workers' compensation programs. However, the SAD must be the provider of such programs and the funding for these programs must come from the SAD. We do believe, however, that the better view is to amend SB 1225 to specifically provide for such arrangements by SAD with the City of San Diego.

JOHN W. WITT, City Attorney
By
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