

MEMORANDUM OF LAW

DATE: November 7, 1988

TO: Cruz Gonzalez, Risk Management Director
FROM: City Attorney
SUBJECT: Internal Revenue Code Section 89 Definition of
Highly Compensated

In a memorandum dated September 21, 1988, you asked this office if City Councilmembers are officers for the purposes of the nondiscrimination tests found in Section 89 of the Internal Revenue Code, and if any other individuals should be considered as officers of The City of San Diego beyond the City Manager, Assistant City Manager, Deputy City Manager, City Auditor and Comptroller, and City Treasurer.

Section 89 of the Internal Revenue Code adopts the definition of "highly compensated employees," that is found in Section 414(q) of the Internal Revenue Code, for the purpose of the nondiscrimination tests. That section defines "highly compensated employee" as: (1) a five percent owner, (2) an employee who receives compensation from the employer in excess of \$75,000, (3) an employee who receives compensation from the employer in excess of \$50,000 and is in the group consisting of the top twenty percent of the employees when ranked on the basis of compensation paid during such year, (4) was at any time an officer and received compensation greater than the amount in effect under Section 415(c)(1)(A) for such year (\$45,000).

Unfortunately, the Code does not define the term "officer" for the purpose of the nondiscrimination tests. What is more disheartening is that the only relevant Internal Revenue Service Ruling close to being on point is Revenue Ruling 80-314 which addresses the issue of a corporate officer acting in nominal capacity for the purposes of the discrimination tests found in the Employee Retirement Income Security Act of 1974, Public Law 93-406 (ERISA). Government employees are generally exempt from the provisions of ERISA. The ruling, however, is helpful because it delineates certain criteria that can be used when defining the term "officer" for tax purposes.

The status of officers should be determined upon the basis of all the facts including, for example, the source of their authority, the term for which elected or appointed, and the nature and extent of their duties. As generally accepted in connection

with corporations, the term "officer" means an administrative executive who is in regular and continued service. It implies continuity of service and excludes those employed for a special and single transaction.

Federal case law also provides that the determination of who is an "officer" is "by the nature of the relationship of the particular individual to the corporation" and "The term executive officer implies some sort of managerial responsibility for the affairs of the corporation generally and it imports a close connection with the board of directors and high officers of the company." *Guillory v. Aetna Insurance Company*, 415 F.2d 650, 652 (5th Cir. 1969) citing *Bruce v. Travelers' Insurance Company*, 266 F.2d 781, 784 (5th Cir. 1959).

If we compare these definitions with the generally accepted definition of public officer, some similarities become obvious. According to 63(A) Am.Jur.2d Public Officers and Employees . 9:

The key considerations in determining whether one is a public officer are the nature of the office, the powers wielded, and the responsibilities which are carried out. In making such a determination, the court must look to the nature of the service performed by the incumbent and the duties imposed upon him.

The characteristics of a public office are generally agreed upon, although the distinction between an office and employment may be vague in particular fact situations. The characteristics of a public office include: (1) creation by statute or constitution; (2) exercise of some portion of the sovereign power; (3) a continuing position not occasional or contractual; (4) a fixed term of office; (5) an oath requirement; (6) liability for misfeasance or nonfeasance; and (7) the official has an independence beyond that of employees. A public officer may be either appointed or elected; customarily will

perform a public or governmental duty; the enforcement of government regulations or the control of the general interest of society will be confided in him; usually he will have general duties as part of the regular administration of government; and the right to emoluments.

It can certainly be argued that City Councilmembers are perhaps more analogous to members of a board of directors and that the "officers" of The City of San Diego are only those found in the executive and administrative services of the City as set forth in Article 5 of the Charter. However, it can also be argued that because each Council district is a separate City department pursuant to the provisions of Municipal Code Section 22.1801, each Councilmember is a department head and an appointing authority and, therefore, an "officer" within the meaning of Section 414(q) of the Internal Revenue Code.

As you are aware, at the present time there are no regulations issued by the Internal Revenue Service concerning the application and interpretation of Section 89. In light of the above, and the lack of definitive regulations, the possibility that the Internal Revenue Service would characterize City Councilmembers as "officers" under Section 89 is a reasonably good one. It is also reasonable to assume that the Internal Revenue Service would most likely determine that all department heads and/or appointing authorities of The City of San Diego are also "officers" within the meaning of Section 414(q).

We believe, therefore, that for the specific and narrow purpose of applying the nondiscrimination tests of Section 89 of the Internal Revenue Code, that you consider all members of the City Council to be "officers" within the meaning of Section 414(q) of the Internal Revenue Code, and that the term "officer" also be applied to all of the appointing authorities and department heads listed in Article 5 of the Charter of The City of San Diego and Municipal Code Section 22.1801.

JOHN W. WITT, City Attorney

By

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