

**AGREEMENT BETWEEN THE CITY OF SAN DIEGO AND
SAN DIEGO POLICE OFFICERS ASSOCIATION
RELATED TO PAYMENT-IN-LIEU OF ANNUAL LEAVE**

Pursuant to the provisions of the Meyers-Milias-Brown Act (MMBA) and San Diego City Council (Council) Policy 300-06, this Side Letter Agreement (Agreement) is entered into between the City of San Diego (City) and the San Diego Police Officers Association (POA). The City and POA are collectively referred to as the "Parties."

Background and Overview

This Agreement relates to modifications to the City's payment-in-lieu (or pay-in-lieu) of annual leave program whereby an employee has the option to take the cash value of annual leave earned instead of taking the time off. This Agreement was reached after a good faith meet-and-confer process under the MMBA in response to City's determination, based on the advice of tax counsel, that this program feature must be modified to comply with federal Internal Revenue Service (IRS) Regulations.

Under these Regulations, the IRS considers income to be received for tax purposes if the individual actually receives it or has an option to receive it during each tax year. This is known as the constructive receipt doctrine. Several IRS private letter rulings illustrate how the IRS applies this doctrine when employees are given the option to take pay-in-lieu, i.e., convert annual leave to cash, as the leave is being earned. In these private letter rulings, the IRS has concluded that annual leave accruals, which are subject to this pay-in-lieu option, must be included in an individual's gross income for the taxable year or payroll period in which these accruals were credited to his or her account, even if the individual does not elect to receive the income in that taxable year or in that pay period. As far as the IRS is concerned, the fact that the individual has an unrestricted right to receive pay-in-lieu of annual leave means that he or she is in constructive receipt of this cash at that time and payroll taxes must be deducted.

Application of this constructive receipt doctrine to the City's pay-in-lieu of annual leave program would mean that all annual leave would have to be taxed as it is earned because the City's program allows the employee an unimpeded option to take this leave as cash rather than to take the time off.

However, IRS Regulations also provide that the constructive receipt doctrine will not apply if an individual's control over the receipt of income is subject to substantial limitations or restrictions. Several private letter rulings have held that income is not constructively received as annual leave accrues if an individual has made an irrevocable election before the tax year in which it accrues to receive only a designated portion of this annual leave as cash.

Relying on these private letter rulings as an indication of how the IRS would view the City's pay-in-lieu of annual leave program, the City has proposed and POA has agreed to modify the program prospectively to comply with applicable IRS Regulations.

The modification is designed to preserve the employee's ability to receive pay-in-lieu of annual leave but substantially limit that ability so that there is no "constructive receipt" as the IRS defines it. To accomplish this, an employee will be required to make an irrevocable election annually by December 1st, or by the preceding Friday if December 1st falls on a Saturday or Sunday, to specify how much pay-in-lieu of annual leave to be earned in the *following* calendar year the employee wishes to receive during *that calendar* year.

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The details related to the administration of this modified pay-in-lieu of annual leave program are set forth below. Unless otherwise noted herein, an employee's right to earn and use annual leave as specified in Personnel Regulation Index Code I-2 and in any applicable MOU, remains unchanged.

Terms of Agreement

The Parties agree as follows:

1. The Parties have met and conferred in good faith in accordance with the MMBA on the subject matter and terms of this Agreement.
2. The Parties will submit this Agreement to the City Council for final determination. This Agreement is not binding on the City or POA unless and until it is approved by a two-thirds vote of the Council in accordance with San Diego Charter section 11.2. This Agreement will take effect upon the date of final passage of a City Council resolution approving this Agreement.
3. Effective for all calendar years beginning on and after January 1, 2019, employees may convert up to 125 hours of annual leave to cash as pay-in-lieu each calendar year, subject to the following rules:
 - a. If an employee fails to elect by December 1st each year or by the preceding Friday if December 1st falls on a Saturday or Sunday, to receive any of the annual leave hours he or she will earn in the following calendar year as pay-in-lieu, his or her annual leave will accrue in accordance with the applicable Personnel Regulation, Index Code I-2.
 - b. If an employee irrevocably elects by December 1st each year or by the preceding Friday if December 1st falls on a Saturday or Sunday, to receive a portion of the annual leave hours he or she will earn in the following calendar year, not to exceed 125 hours total for the calendar year, as pay-in-lieu, the City will create an account where the employee's designated pay-in-lieu accruals will be credited. This account will be referred to as a "pay-in-lieu bucket" ("PIL Bucket") and will be kept separate from the employee's annual leave accrual account or "annual leave bucket" ("AL Bucket"). The employee's election must designate the amount of his or her annual leave being earned each pay period which he or she wishes to have credited to the PIL Bucket; this designation may be stated as an even percentage (e.g., 10 %, 20%, 30%, 40%, etc.) of the leave earned during each pay period up to 100%. Starting with the first pay period of the calendar year, the PIL Bucket will be credited with the designated amount of the employee's annual leave each pay period until the employee's full election amount is reached, not to exceed 125 hours. Any annual leave being earned in a pay period which is not credited to the employee's PIL Bucket will be credited to the employee's AL Bucket. The balance available in the employee's PIL Bucket, if any, will be specified

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on his or her timecard and paystub. In addition, the employee's anniversary date and AL cap will also be displayed on the employee's timecard.

- c. An employee must make an irrevocable election by December 1st each year or by the preceding Friday if December 1st falls on a Saturday or Sunday, if the employee wishes to participate in the pay-in-lieu of annual leave program for the following calendar year. Elections will not carry over from one calendar year to the next calendar year. An employee who fails to elect by December 1st each year or by the preceding Friday if December 1st falls on a Saturday or Sunday, to participate in the pay-in-lieu of annual leave program for the following year will be deemed to have elected not to participate and he or she will be prohibited from receiving any pay-in-lieu during that year except as, and only to the extent, permitted under Section 4.
 - d. At least 60 days in advance of this annual December 1st deadline, the City will provide employees with notice and an explanation regarding the need for an irrevocable election as well as the relevant form for making the election. At the same time, the City will remind employees of the citywide cap maximums and how the pay-in-lieu election affects that cap.
 - e. All pay-in-lieu hours which accumulate in the employee's PIL bucket must be paid out to the employee in the calendar year in which these hours are earned. Pay-outs will be either employee-initiated or City-initiated. An employee may make up to two requests during the calendar year for a payout from his or her PIL Bucket. The timing of either request is entirely up to the employee and payment will occur as designated on the City approved form. However, an employee cannot request the pay-out of any pay-in-lieu hours until those hours have been earned and accrued in his or her PIL bucket. Since no PIL hours may be carried over to the following year, the City will initiate a pay-out of all hours accrued in the employee's PIL Bucket no later than the final paycheck issued in the calendar year regardless of the number of pay periods in the calendar year and regardless of the number of hours.
4. When pay-in-lieu is cashed out, it will be paid based on the employee's rate of pay at the time it is paid. All pay-in-lieu pay-outs are taxable income, subject to all applicable withholdings and payroll deductions.
 5. Existing caps on the accrual of annual leave will remain in effect. However, any hours up to the 125-hour maximum which an employee allocates to his or her PIL bucket for the ensuing calendar year will not count toward the calculation of this cap.
 6. Effective for calendar years beginning on and after January 1, 2019, an employee's election with regard to pay-in-lieu shall be irrevocable except in the event of an unforeseeable financial emergency subject to the following rules:
 - a. In the event of an unforeseeable emergency, as defined in subsection b, an employee may apply to the Risk Management Department to receive pay-in-

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lieu of annual leave accrued on or after January 1, 2019, but limited to the amount that is reasonably necessary to satisfy the emergency need, including any amounts that may be necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated as a result of the cash out. If the Risk Management Department approves an employee's application, the City will pay the employee the pay-in-lieu amount the Risk Management Department deems necessary to meet the emergency need.

- b. "Unforeseeable emergency" means a severe financial hardship of the employee resulting from an illness or accident of the employee, the employee's spouse, or the employee's dependent (as defined in Internal Revenue Code section 152, and, without regard to Internal Revenue Code sections 152(b)(1), (b)(2), and (d)(1)(B)); loss of the employee's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, such as damage that is the result of a natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a direct result of events beyond the control of the employee. For example, the imminent foreclosure or eviction from the employee's home may constitute an unforeseeable emergency. In addition, the need to pay for medical expenses, including non-refundable deductibles, as well as for the cost of prescription drug medication, may constitute an unforeseeable emergency. Finally, the need to pay for the funeral expenses of a spouse or dependent (as defined in Internal Revenue Code section 152, and, without regard to Internal Revenue Code sections 152(b)(1), (b)(2), and (d)(1)(B)) of the employee may also constitute an unforeseeable emergency. Neither the purchase of a home nor the payment of college tuition is an unforeseeable emergency. Pay-in-lieu of annual leave on account of an unforeseeable emergency will not be paid to the extent that such an emergency is or may be relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the employee's assets, to the extent liquidation of such assets would not itself cause severe financial hardship. For this purpose, an employee cannot receive any pay-in-lieu of annual leave on account of an unforeseeable emergency to the extent that he or she has unused amounts accrued in his or her PIL Bucket, if any.
7. The City agrees to prepare and distribute a Citywide communication to all employees and will train payroll specialists on the changes in the administration of City's long-standing pay-in-lieu of annual leave program, no later than October 1, 2018. Among other efforts, the City will train its payroll specialists to explain and administer this modified program and will develop appropriate written materials and forms. The Parties will continue to meet and consult regarding this information campaign and the written communications associated with it.
 8. Since this modification in the City's pay-in-lieu of annual leave program requires a transition from a fiscal-year to a calendar-year platform, the City will also communicate the following information to employees on or before April 1, 2018, or immediately after Council approval is received if later than April 1, 2018:

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- a. That a change in administration of the pay-in-lieu of annual leave program is coming for implementation during calendar year 2019 in order to be in compliance with IRS regulations;
 - b. That this change will require employees to make a voluntary and irrevocable decision by December 1st each year, or by the preceding Friday if December 1st falls on a Saturday or Sunday, whether or not to opt-into the pay-in-lieu of annual leave benefit for the following year;
 - c. That this change means the following for calendar year 2018:
 - i. Employees may sell up to 125 hours of annual leave as "pay-in-lieu" on or before June 30, 2018, in accordance with current rules;
 - ii. Employees may sell up to another 125 hours of annual leave as "pay-in-lieu" between July 1, 2018, and December 14, 2018, in accordance with current rules, but, due to payroll periods which span the 2018 and 2019 calendar years, employees must make a timely request to assure pay-out in their last paycheck of the 2018 calendar year which will be on 12/28/18.
 - iii. Any earned, accrued annual leave which an employee has not sold as "pay-in-lieu" on or before December 14, 2018, will no longer be available to convert to pay-in-lieu unless a qualifying unforeseen emergency occurs as described above in Section 4, subsections a and b.
 - iv. For calendar year 2019, and for each calendar year thereafter, an employee will have up to 125 hours to allocate to his or her PIL bucket for that calendar year as described above.
9. Specific provisions in this Agreement supersede any previous agreements, whether oral or written, regarding the subject matter of this Agreement. However, unless expressly covered in this Agreement, all wages, hours, and other terms and conditions of employment presently enjoyed by POA-represented employees, whether stated in an MOU, Personnel Regulation, Administrative Regulation or in any other enforceable document, remain in full force and effect.
10. Upon approval by the City Council, this Agreement is intended to be read in conjunction with the MOU and where in conflict on the specific issue covered by this Agreement, this Agreement will control.
11. The Parties will incorporate the language set forth in this Agreement into any successor MOU negotiated by the City and the POA which is approved by the City Council, as well as into and applicable Administrative Regulations and Personnel Regulations.


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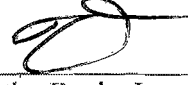
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This Agreement is executed, by the following authorized representatives of each party:

San Diego Police Officers Association

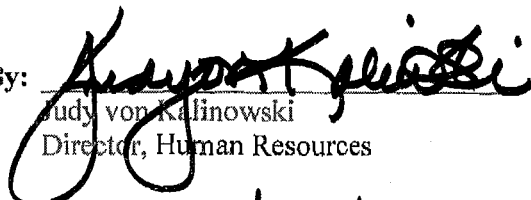
City of San Diego

By: 
Jack Schaeffer, President

By: 
Timothy Davis, Lead Negotiator

Date: 3/15/2018

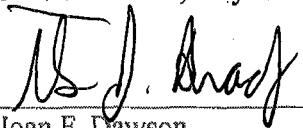
Date: March 16, 2018

By: 
Judy von Kalinowski
Director, Human Resources

Date: 3/14/18

Approved as to form this 16th day of April, 2018.

MARA W. ELLIOTT, City Attorney

By: 
Thomas J. Brady for Joan F. Dawson
Deputy City Attorney