



Board Member Compensation — Issues Related to Declining Payment

Wisconsin school districts have the authority to establish the compensation of school board members for the performance of their duties as elected officials. That compensation is subject to deductions for both income and Federal Insurance Contributions Act (FICA) taxes. Social Security and Medicare taxes make up the FICA taxes. Historically, it has not been uncommon for board members to decline their board compensation; however, according to the Internal Revenue Service (IRS), they were still responsible for the payment of income and FICA taxes on that compensation.

Unlike city, village, town, or county elected officials, until recently there was no statutory provision which specifically permitted board members to decline compensation for their board duties so as to avoid income and FICA taxation. The Wisconsin Legislature, however, enacted 2017 Wisconsin Act 9 (Act 9), which became effective on June 3, 2017, which specifically permits school board members to decline their salary or per-meeting payments. This statute was enacted in an attempt to avoid potential income and FICA tax consequences to board members and their districts with respect to board members who decline authorized compensation. However, that statute contains ambiguities that present practical issues in the timing and manner in which board members exercise this statutory right.

This *Legal Comment* will discuss board members' compensation,

review the duty of a district to deduct income and FICA taxes from that compensation, and analyze the impact of Act 9 permitting board members to decline their salary.

■ Board Member Compensation

Although school boards in common and union high school districts have broad powers, they are subject to the authority vested in the annual meeting of electors. One of the powers reserved to the annual meeting is to “vote annual salaries for school board members, or an amount for each school board meeting the member actually attends.”¹ Thus, in common and union high school districts, the electors have the authority to establish the compensation of board members at the annual meeting. In unified school districts, the school board itself has this authority.²

The authority to establish board member compensation does not authorize a board member to receive both an annual salary and a per-meeting stipend for each board meeting attended. If the annual meeting or a unified school district board authorizes a per-meeting stipend, the statute limits the payment to an amount for each board meeting the member actually attends. Under the statutory language, it is likely that stipends cannot be given for attending seminars, conventions, committee meetings, or negotiation sessions, which

are not board meetings. If the electors or a unified school district board approve an annual salary, the statute allows the establishment of higher salaries for board members who serve on committees or as board officers in recognition of the additional time they spend on school-related matters.

In addition to these payments, school boards may provide for the payment of premiums for hospital, surgical, and other health and accident insurance and life insurance for employees and officers and their spouses and dependent children, including board members.³ If approved by electors at an annual meeting or by the school board in a unified school district, board members may also be reimbursed for district-related travel based on the standard federal mileage rate (or less) and for meals and lodging related to district operations.⁴ Such premium payments and reimbursements are tax-free payments not subject to deductions.

■ Income Tax Withholding

The Internal Revenue Code (IRC) requires employers to withhold federal income taxes on wages paid to employees. Generally, wages include all remuneration for services performed by an employee for the employer.⁵ For income tax withholding purposes, the IRC definition of “employee” includes “an officer or elected official of any political subdivision of the state,” which encompasses school board members.⁶ Therefore, a

We believe Act 9 can be relied upon by board members who follow Act 9's requirements so as not to pay income and FICA taxes.

district is obligated to withhold federal income tax from a board member's compensation. Because the Wisconsin Department of Revenue generally follows IRS rules in connection with income tax withholding, a district is further obligated to withhold Wisconsin income tax from board member taxable compensation.

■ FICA Tax Withholding

An employee is obligated to pay a portion of the FICA tax that is calculated on the employee's wages. Under the IRC section setting forth the requirements related to FICA tax withholding, an employer is obligated to withhold an employee's portion of the FICA tax (*i.e.*, 7.65 percent of compensation) from the employee's compensation.⁷ The employer is also responsible for paying 7.65 percent FICA tax on the employee's compensation.⁸

The IRC, however, does not define the term "employee" for purposes of determining a district's obligation to withhold FICA tax in the same way an "employee" is defined for income

tax withholding purposes. Instead, the IRC section defining an "employee" for the purpose of FICA tax withholding provides that "an employee is defined as an individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee."⁹

The IRS has taken the position that the compensation of public officials, including elected officials such as school board members, is subject to FICA tax withholding. In 2006, the IRS revised and reissued the Federal-State Reference Guide which sets forth the IRS interpretation of federal law and related regulations, rulings, and case law on the withholding of FICA taxes and, for the first time, concluded that elected officials are "employees" for FICA tax withholding purposes.¹⁰

■ Tax Implications of Declining Compensation

For a variety of reasons, some board members decline to accept their

authorized compensation (either salary or per-meeting payments established for attendance at each school board meeting). In such cases, board members typically either direct the district to retain such payments as part of the general fund or direct its payment to a charitable or other cause. Even though they do not personally receive their authorized compensation, the IRS takes the position that such board members are subject to taxation for the authorized amounts under the doctrine of "constructive receipt," *i.e.*, since they were authorized to receive the payment and ultimately controlled its disposition, they are taxed on it.

This stance appears to conflict with an IRS exception to the "constructive receipt" rule with respect to individuals who render services directly and gratuitously to, among other organizations, political subdivisions of states, including school districts.¹¹ However, the IRS, in at least two instances, has concluded that taxable income resulted when an elected official refused to accept that

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official's pay. When a member of Congress returned a portion of his salary to the U.S. Treasury, the IRS ruled that the full amount of his salary was includable in his gross income.¹² Similarly, a state public official who took five furlough days and donated his salary for those days to the state treasury was required to pay tax on the donated salary, even though the state had asked certain administrative personnel to take such days without pay.¹³

Based on these rulings, prior to Act 9, if a school board member declined to accept authorized compensation, the board member was required to recognize income for the amounts the board member was entitled to receive. In that case, the board member, while required to include that amount as taxable income, would also be able to take a charitable contribution deduction on Form 1040, Schedule A, for contributing the compensation to a qualifying organization, provided that the board member itemized deduc-

tions.¹⁴ Board members who took the standard deduction could not take advantage of this deduction.

Act 9 was enacted to address the "constructive receipt" issue.¹⁵ Under this law, a school board member may decline that member's salary by sending written notification to the district clerk and treasurer that the board member wishes to refuse his or her salary. "Salary" under the statute means both the authorized annual salary and the per-meeting amount established for attendance at each school board meeting. A "school board member" also includes a school board member-elect.

By establishing procedures for board members to decline their compensation prior to it being "earned," Act 9 gives rise to a strong and compelling argument that such board members are not liable for income or FICA taxes on such compensation because the board members have not "constructively received" that compensation. However, the IRS has not

taken an official position on the impact of Act 9 on the taxability of declined compensation and, until it does, the effect of Act 9 on this issue is not final from a federal standpoint. Notwithstanding this, we believe Act 9 can be relied upon by board members who follow Act 9's requirements so as not to pay income and FICA taxes.

In order to comply with Act 9, a board member must submit the notification within the specific statutory deadlines. This designation is irrevocable for one year. It must be renewed annually within the required time frames. The applicable procedures are as follows:

- For a school board member continuing the member's term, the board member must send the notification at least 30 days before the start of the board member's next taxable year, *i.e.*, before December 1. The notification applies only to that taxable year. A board member may renew the



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member's refusal by sending a notification annually within the established time frames.

- For a board member who is elected or appointed to the school board and the board member's current taxable year does not end within three months of the day on which the board member's election is certified or the board member is appointed (*e.g.*, April), the board member must send the notification no later than the day on which the board member takes the official oath of office and before the board member performs any services in his or her capacity as a board member. The notification applies only to the taxable year in which the school board member's election is certified or the member is appointed.
- If the school board member's current taxable year ends within 3 months of the day on which the board member's election is certified or the board member is appointed to the board (*e.g.*, October), the notification applies until the end of the member's next taxable year.

There are several ambiguities to the new legislation. First, it is not clear how incumbent board members who are up for election in April are to provide notice with respect to following taxable year and compensation after April. In order to decline compensation for compensation authorized for January 1 through certification of the April election, the board member must provide written notice before December 1 of the preceding year. However, since the Board member may not decide to run for re-election prior to that date and since re-election to a new term is not official until the election certification, it is unclear how a board member can decline compensation for the period from the April election certification until December 31 prior to certification, given that the board member is not legally entitled to compensation until certification and taking the oath of office.

There are two possible ways to handle this. The first is to provide written notice prior to December 1 for the January 1 through April compensation and then a second notice in April prior to taking the oath of office for the April through December compensation. A second way to address this situation is to provide one notice in November, which states that the notice applies to "compensation received from January 1 through December 31 [year], including any portion of such taxable year that is covered by any additional term of office to which I may be elected or appointed." Both are reasonable ways to proceed, with the latter being more efficient.

The second ambiguity involves the impact of the notice. If a board member provides the appropriate notice declining compensation, the district cannot pay the employee "beginning with the first pay period that commences after the notification applies." However, the commencement of that pay period may not line up with January 1 and tax may be due for the portion of any board compensation for January 1 to the first day of the first January pay period. To avoid this, district's may want to establish a "pay period" for board members that begins on January 1.

Finally, for persons elected or appointed to a new term of office, notification of refusal of salary has to take place no later than the day they take the oath of office and before they perform any services in their capacity as a board member. Under these procedures, an appointee to a board vacancy may have a short time in which to submit a notification of refusal of salary because appointees are deemed to have accepted the appointment unless they decline the appointment within five days of receiving notice.¹⁶ Once that five-day period has passed without a written declination of the appointment, an appointee arguably could be "performing service." Although the statutes do not definitively answer the question, the deadline for an

Policy Resource Guide subscribers: Topic 164 of the PRG includes a sample form that a school board member may use to notify the district of a decision to refuse their board salary. For more information, visit wasb.org.

appointee to send the notification may be the earlier of (1) the time at which the appointed board member performs any services in his or her capacity as a board member; (2) the date the appointee takes the official oath; or (3) the fifth day after the appointee receives notification of his or her appointment.

Conclusion

Pending formal approval from the IRS, Act 9 is intended to provide board members who wish to decline payment for their board services with a means by which to do so without tax implications. However, specific procedural steps must be followed each year to accomplish this outcome and board members should be reminded of these steps prior to December 1 of each year and immediately upon election or appointment to office.

End Notes

1. Wis. Stat. s. 120.10(3).
2. Wis. Stat. s. 120.44.
3. Wis. Stat. s. 66.0137(5).
4. Wis. Stat. s. 120.10(4).
5. IRC s. 3401(a).
6. IRC s. 3401(c).
7. IRC s. 3102.
8. IRC s. 3111.
9. IRC s. 3121(d)(2).
10. IRS Publication 963 (Rev. Oct. 2006).
11. Trs. Reg. ss. 1.61-29c).
12. Rev. Rul. 56-126.
13. IRS Letter Ruling 8325078.
14. IRC s. 170(a)(1).
15. Act 9 created Wis. Stat. ss. 120.07 and 120.45.
16. Wis. Stat. s. 17.26(3).

This Legal Comment was written by Michael J. Julka, Steven C. Zach, Christopher T. Schmidt and David P. Weller, WASB Legal Counsel. For additional information on related topics, see Wisconsin School News: "Taxes on Board Member Compensation" (October 2008); and "The Duties and Responsibilities of School Board Officers" (March 2007).