



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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The Honorable Kay Bailey Hutchison
United States Senator
10440 North Central Expressway, Suite 1160
LB 606
Dallas, TX 75231

Attn: Mary Fae Kamm

Dear Senator Hutchison:

This letter replies to your inquiry dated March 15, 2000, on behalf of the [REDACTED] and the [REDACTED] (the Districts). The Districts are concerned about advice from the Internal Revenue Service (IRS) that water district directors are employees of the districts they represent.

The Districts are concerned because that advice conflicts with previous advice provided by the IRS. The advice requires the Districts to report the amounts paid to the water district directors on Form W-2 and to withhold and pay federal employment taxes on those amounts. The District is concerned about the additional cost and record keeping that will require. While I cannot discuss an individual's tax information without his or her permission, I can provide the following general information, which I hope will assist you in responding to your constituents.

Amounts paid to water district directors from a government fund are properly treated as wages. Any advice provided by the IRS to the contrary was in error. The Districts should report amounts paid to the employees on Forms W-2 and the employees should report the amounts as wages on Forms 1040.

The letters you forwarded to this office state that water district directors are typically residents of the water districts that they represent. They are elected by their neighbors to oversee the water and wastewater services. Thus, they are elected public officials.

Various Internal Revenue Code (Code) provisions govern whether an elected official is subject to employment taxes. In general, when a public official receives payment directly from the members of the public with whom he does business, section 1402(c)(1) of the Code provides that the public official is engaged in a trade or business and is subject to Self-Employment Contribution Act (SECA) taxes. The payments are considered fees, not wages, and are properly reported on Form 1099. However, when a public official receives remuneration or salary from a government fund, and may not keep amounts he collects from the public in his course of duties, the payments are wages and are properly reported with Form W-2. See Empl. tax reg. sec. 31.3401(a)-2(b)(1); Rev. Rul. 74-608, 1974-2 C.B. 275. Thus, the source of a public official's payments determines whether the amounts received constitute fees or wages. Because water district directors are compensated from a government fund, the amounts they are paid are properly treated as wages, reported with Form W-2.

Wages reported with Form W-2 may be covered by social security insurance and Medicare insurance. Subject to limited exceptions, state and local government employees are subject to Medicare tax and state and local government employees who are not covered by a public retirement program are subject to social security tax. A detailed explanation of social security and Medicare coverage of state and local government employees is provided in Code sections 3121(b)(7) and 3121(u) and the regulations corresponding to those Code sections.

This letter will be made available for public inspection after names, addresses, and other identifying information have been deleted, as appropriate, under the Freedom of Information Act.

I am sorry for the confusion the previous IRS letter has created. I hope this information is helpful to you in responding to the Districts. As requested, I am enclosing a copy of your letter. If you have questions regarding this letter, or if I can be of further assistance, please contact Linda Alsalihi (ID No. 50-14451) of my staff at (202) 622-6040.

Sincerely,

MARY OPPENHEIMER
Assistant Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure