

IRS Hearing on Definition of Governmental Plan (REG-157714-06)
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Comments in order of delivery:

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Good morning, (Ladies and Gentlemen). Thank you for allowing me to present oral comments today regarding the IRS and Treasury's Advanced Notice of Proposed Rulemaking on the definition of governmental plan.

My name is Cindy Rougeou, and I am the executive director of the Louisiana State Employees' Retirement System. I am also Second Vice President of the National Association of State Retirement Administrators (NASRA), on whose behalf I am testifying today. NASRA members are the directors of the nation's largest state-administered public retirement systems. The 81 plans that are overseen by NASRA members collectively hold nearly two-thirds of all state and local pension assets and membership. While all are administered at the state-level of government, the governmental entities that participate in these plans vary significantly.

Some state retirement systems are like the one I administer - covering only employees of the executive, legislative and judicial branches of the state. Others cover hundreds or even thousands of local, county, special district and other agencies within the state. It will be important for Treasury and the Service to consider the effect the draft proposed rules will have on single employer plans such as mine, as well as those governmental plans that cover multiple participating government employers.

Given the varying legal constructs of state and local governments, agencies, instrumentalities, and their retirement systems, the impact of the proposed rules will differ from state to state, and entity to entity. However, safe harbors, grandfathering treatment, and transition requirements will be paramount to ensuring the administrability of all governmental plans going forward.

These key areas were the focus of written comments submitted jointly by NASRA, the Government Finance Officers Association, the National Association of Government Defined Contribution Administrators, the National Conference on Public Employee Retirement Systems and the National Council on Teacher Retirement. My comments today will focus primarily on the needed safe harbors outlined in our comments, which

received a great level of interest based on input we gathered from our collective memberships.

The facts and circumstances test outlined in the draft regulations requires an analysis of five main factors and eight other factors. Completing such an analysis for a state-level plan covering hundreds, or thousands, of participating employers is a complex task. Further, it does not provide a level of certainty to those responsible for administering the plan in compliance with these regulations.

Alternatively, safe harbors would allow the majority of entities to use simple and conclusive determinations regarding governmental status under Section 414(d), leaving the facts and circumstances test for only those entities that did not meet one of the safe harbors.

Our written comments outlined seven safe harbors. We recommend that the satisfaction of any one safe harbor should permit an entity to establish and maintain a governmental plan under IRC 414(d) for its employees, and/or participate in a multiple employer governmental plan. If a safe harbor is met, the entity and the retirement system would not need to consider any other factor.

1. The first safe harbor we recommend pertains to **Fiscal Responsibility**. This would apply if a State or political subdivision has fiscal responsibility for the general debts and other liabilities of the entity, including employee benefits. This is a safe harbor that was described in the ANPRM. This would require general fiscal responsibility – so that the safe harbor would not be failed if the entity had other sources of funding.
2. The second safe harbor, **Elected Board**, was also described in the ANPRM. It would pertain where a majority of the members of the governing board of the entity are either a) controlled by a State or political subdivision thereof, including the power to appoint and/or remove a majority of the governing body, or b) are elected through periodic, publicly-held elections by the voters.
3. An additional safe harbor would pertain to **Sovereign Powers**. If the entity has been delegated one or more sovereign powers of a state or a political subdivision the entity would meet this safe harbor. The definition of sovereign powers would include taxation, police, eminent domain, but would also include sovereign powers as defined by the state constitution.
4. **Government Agent** would be the fourth safe harbor. This would apply if the entity has been established and empowered by specific statute or ordinance to be an agent of a state or political subdivision to perform a governmental function on behalf of a state or political subdivision.
5. A fifth safe harbor would pertain to **Federal Tax treatment**. If an entity has been determined to be a governmental agency or instrumentality for purposes of federal income tax, federal employment tax, or for the purposes of the issuance

of tax exempt bonds, they should meet this safe harbor. Additionally this safe harbor would also apply if the entity is covered by a Section 218 agreement or a modification to such agreement, if the entity has the authority to issue tax-exempt bonds under IRC Section 103(a), or if the entity has a Section 115 ruling.

6. To provide consistency of treatment across federal agencies, an additional safe harbor should also apply for those treated as governmental entities pursuant to a **Federal Law other than the Internal Revenue Code, or by a Federal Agency (other than the IRS and Treasury)**.

For example, the Census Bureau publishes a “Census of Governments” every five years, as required by law under Title 13, U.S. Code, Section 161, which is based on their analysis of a number of factors that are similar to the factors described in the ANPRM. It has been recommended in other written testimony that entities that are included in the Census of Governments should be treated as a governmental entity under IRC Section 414(d). This would allow for a straightforward and conclusive determination of all governmental entities classified as such by the Census Bureau. Further, it would likely eliminate a duplication of effort and resources by other federal, state and local governments analyzing the same factors.

7. The final safe harbor would pertain to those entities that have received a **State or Federal Court Determination** that they are an agency or instrumentality of a state or a political subdivision. This would also apply where a federal or state court has determined that a particular type of entity is a governmental entity. This safe harbor would not require that each entity have its own court decision.

In addition to safe harbors, we also hope the Service and Treasury will include a provision for grandfather treatment of existing employers and employees in governmental plans. Even if an entity does not meet the standards in the final regulations, state and local governments should be permitted to extend grandfather treatment to current and/or future employees of the entity, as provided under state and local laws. As such, a grandfathered entity could continue to maintain and/or participate in a governmental plan to the extent provided by state or local law.

The degree to which grandfathering treatment is allowed will also dictate the type of transition rules going forward. At a minimum, an appropriate time period must be allotted to accommodate any needed actions by the state legislature. Furthermore, flexibility will be needed to accommodate those entities whose status changes from a governmental entity to a private entity after the regulations are final. For multiple employer governmental plans, the regulations should be clear that if reasonable procedures are in place to determine whether a participating employer is a governmental entity, the governmental plan's status will not be adversely affected if there is a subsequent determination that the entity is not a governmental entity. Similarly, a multiple employer governmental plan should not have the plan's

governmental status jeopardized if a participating employer has misreported an individual's employment status affecting their plan eligibility.

The ANPRM specifically asked for comments regarding the need for a de minimis standard. To the extent that proper grandfathering, transition and correction procedures can be included in the final rule, a prospective de minimis standard would not be necessary. If the final rules do not provide such relief to protect plans' governmental status, a de minimis standard may be required.

We understand that even with further clarity in the final regulations, there will still be many instances when an entity's status will not be clear. In order to provide protection for the governmental plan, the employer, and the employees, we strongly urge the IRS to establish an expedited ruling process to determine governmental entity status, possibly with fees lower than what is required for private letter rulings so as to not discourage use of the process.

Finally, we would encourage the IRS to consider creating a checklist to be used for governmental plan status as part of the determination letter process. The checklist could include the safe harbors and also the entire list of factors as they finally emerge.

We thank you for the opportunity to participate in this public hearing. I would be happy to answer any questions you may have at this time.

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Good afternoon, I am Meredith Williams, executive director of the National Council on Teacher Retirement.

- NCTR
 1. NCTR almost a century old (90th annual convention this October); represents public retirement systems in the United States and its territories to which teachers belong.
 2. NCTR has 68 state, territorial, and local pension systems as members, serving more than 19 million active and retired teachers, non- teaching personnel, and other public employees, with combined assets of almost \$2 trillion in their trust funds.
 3. NCTR membership runs to the plan; thus, in addition to plan executive directors and administrative staff, NCTR also represents trustees
 4. Comments based on letter submitted by NCTR, National Association of State Retirement Administrators, Government Finance Officers Association, National Conference on Public Employee Retirement Systems, and National Association of Government Defined Contribution Administrators.

- IMPORTANT ISSUE TO NCTR
 1. Based on a joint survey with NASRA of our memberships, approximately 85% of systems responding have employers other than the state participating in their plan.
 2. Of these, approximately 70% have employers other than conventional units of local governments (such as counties, cities, towns and villages) or school districts/corporations or wholly public universities/colleges in their systems.
 3. Of these other non-state. Non-conventional employers, about 59% are employers created/existing pursuant to a statute specific to that employer or class of employers and performing a public function under such statute/ord.

- IRS TO BE COMMENDED
 1. Based on survey of membership, majority said that they would prefer to see "fairly strict" rules limiting the inclusion of quasi-public entities and/or non-governmental entities in governmental plans.
 2. However, given the vast and varying legal constructs of state and local governments and their agencies/instrumentalities throughout the country, the impact of the proposed definitions and requirements will differ from state to state, and entity to entity.
 3. Therefore, appreciate the deliberative approach of the IRS to this project so far, and encourage IRS to continue its careful, measured consideration, development of final regulations.

- FOCUS OF COMMENTS ON GRANDFATHERING, TRANSITION RULES, AND ADMINISTRATIVE CONSIDERATIONS
 1. Grandfathering:
 - ✓ Permissive, not mandatory in order to provide maximum flexibility.
 - ✓ Could extend to both current as well as future employees of grandfathered entity; forcing creation of two separate plans could be very costly, unfair to participants.
 - ✓ Provide example in Colorado if an entity leaves COPERA, it must pay all of its unfunded liability to COPERA at once.
 - ✓ Three types of entities should be considered for grandfathering such that they can continue to establish and maintain and/or participate in a governmental plan to the extent provided by state or local law:

- An entity with a favorable private letter ruling under Rev. Rul. 89-49 or Rev. Rul. 57-128.
 - An entity that is participating in the governmental plan pursuant to the specific terms of state or local law as of the effective date of the final regulations.
 - With regard to a multiple employer plan, an entity that is participating in the plan as of the effective date of the final regulations, pursuant to a procedure provided for in the plan document. This would cover the situation where the plan document allows nonprofit instrumentalities to participate in a plan subject to approval by the plan's governing body. This grandfather would apply if the plan's governing body had followed a good faith, reasonable interpretation of IRC Section 414(d).
- ✓ The entity would be treated as a governmental employer for all purposes of the plan and plan qualification, and the employees of any entity that was grandfathered would be treated for all purposes as permissible participants in a governmental plan. For example, this would mean that the grandfathered entity would be allowed to have a pick-up plan and that contributions and benefits would be subject to the special rules applicable to governmental plans. In the case of a multiple employer plan, all participating employers, including grandfathered employers, would be governed by the terms of the plan.
2. Transition Provisions:
- ✓ After the regulations are finalized, if governmental plans are required to make plan document changes, the time period for making such should reflect the fact that many governmental plans must be amended by action of the state legislature. For example, the later of a date certain OR “the close of the first regular legislative session of the legislative body with authority to amend the plan that begins on after the date that is three months after the final regulations are published.”
 - ✓ On an on-going basis, if the status of an employer changes from a governmental entity to a private entity, the employees covered by the plan prior to the conversion should be permitted, but not required, to remain in the governmental plan.
3. Administrative Considerations
- ✓ Multiple employer plans can have hundreds or even thousands of participating employers. Therefore, the regulations should make it

clear that, (1) if a multiple employer governmental plan has reasonable procedures in place to determine whether a participating employer is a governmental agency on instrumentality, then the multiple employer governmental plan's status will not be adversely affected if there is a subsequent determination that a particular employer is not a governmental entity; and (2) if a multiple employer governmental plan reasonably relies on the participating employer's representation as to the eligibility of participating employees, the plan's governmental status should not be jeopardized if the employer has misreported an individual's employment status.

- ✓ Where a correction is needed and employees are not allowed to participate in a governmental plan because they are not governmental employees, then those employees should be allowed to roll-over their accounts rather than be required to take a taxable distribution. In the vast majority of cases, the employees have no discretion with regard to their participation in the governmental plan. It is unfair to require them to take a taxable distribution when allowing a rollover would allow some protection of their retirement funds.
- ✓ Prospective de minimis standards would not be necessary if the IRS and Treasury agree with our suggestions on grandfathering and transition. However, if the final rules do not provide other relief that protects plans' governmental status, a de minimis standard should be included in the final rules.
- ✓ The IRS should establish an expedited ruling process to determine governmental entity status, with a reduced fee that does not discourage use of the process. We would encourage the IRS to consider an approach similar to the approach taken in the waiver of the 60-day rule for indirect rollovers. These ruling requests could be made by the employer, the employee, and/or the plan.
- ✓ The IRS should create a checklist to be used for governmental plan status as part of the determination letter process. The checklist could include the safe harbors and also the entire list of factors as they are determined in the final regulations.