

## ALERTS AND UPDATES

# IRS Issues Advanced Notice of Rulemaking for Governmental Plans

December 7, 2011

The Internal Revenue Service (IRS) on November 8, 2011, issued an [advance notice of proposed rulemaking](#) (ANPRM) on the definition of "governmental plan" for purposes of Section 414(d) of the Internal Revenue Code (IRC). The ANPRM sets forth an extensive discussion of the IRS's view on the characteristics of a governmental plan. It is important to note that the ANPRM is just the beginning of the guidance process. However, it offers insight into the IRS's criteria on how governmental plan status will be determined.

Section 414(d) of the IRC defines the term "governmental plan" as "a plan established and maintained by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of the foregoing." By contrast, Section 3 (32) of the Employee Retirement Income Security Act (ERISA) uses the phrase "established **or** maintained." Of particular note, the ANPRM outlines certain "major factors" and "other factors" to be used to determine when and if an entity would be deemed to be an "agency or instrumentality" of a state or local government. The major factors to be evaluated include whether:

- The entity's governing board or body is controlled by a state or political subdivision;
- The members of the governing board or body are publicly nominated and elected;
- The entity's employees are treated in the same manner as employees of the state or political subdivision for purposes other than employee benefits (*e.g.*, civil service rules);
- A state or political subdivision has fiscal responsibility for the general debts and liabilities of the entity, including funding responsibility for the plans; and
- In the case of an entity that is not a political subdivision, the entity is delegated under statutory law to exercise sovereign powers of the state or political subdivision.

In addition to the major factors, certain other factors to be evaluated in determining whether an agency or instrumentality is a political subdivision of a state include whether:

- The entity is created by a state, government or political subdivision pursuant to a specific enabling statute that prescribes the purposes and powers of the entity;
- The entity is directly funded through tax revenues or other public sources;

- The entity is treated as a governmental entity for federal employment tax purposes: for example, whether the entity has the authority to issue tax exempt bonds;
- The entity's operations are controlled by a state or political subdivision;
- The entity is determined to be an agency or instrumentality of the state for purposes of state law; and
- The entity is determined to be an agency or instrumentality of the state or political subdivision by a state or federal court for purposes other than Section 414(d).

Another key aspect of the ANPRM is the determination of whether a governmental entity has "established and maintained" a governmental plan. The ANPRM sets forth three factors:

1. The plan is established and maintained by an employer within the meaning of the IRC regulations (notably the requirement that the plan has to be in writing and communicated to employees),
2. The employer is a governmental entity and
3. The only participants covered by the plan are employees of the governmental entity.

There has been significant concern over the years about the status of governmental plans following transactions in which private entities assume responsibility for governmental functions (*i.e.*, privatization). The ANPRM generally provides that if a previous governmental function is privatized, and the private entity assumes responsibility for the plan and employment of the plan's participants, then any plan sponsored by the governmental entity will cease to be a governmental plan upon completion of the transaction, unless (1) the responsibility for the plan is retained by the governmental entity and (2) the plan is frozen upon the privatization transaction. The IRS is specifically looking for commentary on the application of these rules.

Governmental entities now have preliminary guidance regarding the IRS's direction on the issue of governmental plan status. Previously, plan sponsors were resigned to reviewing old private letter rulings and case law that may or may not be followed by the IRS in determining the governmental plan status in a specific scenario. The ANPRM signals the beginning of the dialogue on establishing governmental plan definition. It can be anticipated that through the initial comment period—ending on February 6, 2012—and as proposed regulations work their way into final regulations, input from governmental sponsors and advisors may significantly impact the criteria for determining governmental plan status.

## **For Further Information**

If you have any questions about this *Alert*, please contact any of the [attorneys](#) in our [Employment, Labor, Benefits and Immigration Practice Group](#) or the attorney in the firm with whom you are regularly in contact.

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