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IRS Releases Advance Draft of Proposed Regulations on Governmental Plans

The Internal Revenue Service (IRS) has issued an [advance notice of proposed rulemaking](#) to release rules being considered for determining governmental plan status for qualified retirement plans under Internal Revenue Code (Code) section 414(d). The guidance includes draft proposed regulations, a solicitation for comments, and detailed discussions of the history of governmental plans and the various standards that have been applied by the IRS, Department of Labor (DOL), Pension Benefit Guaranty Corporation (PBGC) and the courts to define governmental plans, as well as summaries of the rules that governmental plans are subject to, or exempt from, under the Code.

Although the draft proposed regulations would be issued under Code section 414(d) to define governmental plans for purposes of the rules for qualified retirement plans under Code section 401(a), the guidance says that the rules would also apply for purposes of the tax shelter annuity requirements under Code section 403(b) and the deferred compensation requirements of Code section 457. In addition, the guidance indicates the IRS consulted with both DOL and PBGC on the standards included in the draft proposed regulations and that the agencies believe there should be a coordinated set of rules to determine governmental plan status for purposes of the Code and Titles I and IV of the Employee Retirement Income Security Act (ERISA).

The guidance notes that Code section 414(d) provides a definition of the term “governmental plan” and that governmental plans are subject to a unique set of qualification rules under the Code, excluding nondiscrimination, vesting and eligibility requirements, as well as many other rules generally applicable to qualified plans. Under Code Section 414(d), governmental plans include plans established and maintained by the federal government, a federal government agency or instrumentality, a state or local government, or a state or local government agency or instrumentality. The draft proposed regulations include standards for identifying both federal government agencies or instrumentalities and state and local government agencies or instrumentalities.

The definitions of both types of agencies or instrumentalities are based on facts and circumstances, and the draft regulations list the factors to be considered in applying the facts and circumstances analysis. For both types of agencies and instrumentalities, the factors listed are based on cases and prior guidance, specifically Rev. Ruls. 57-128 and 89-49. The factors for identifying agencies and instrumentalities of state and local governments are divided into major factors and other factors. As is currently applicable under Rev. Rul. 89-49, satisfaction of one or more factors is not necessarily determinative of whether any entity is governmental.

The major factors are whether:

- The entity’s governing body is controlled by state or local government.
- The members of the governing body are publicly nominated and elected.
- Employees of the entity are treated in the same manner as employees of the state or local government, e.g., they have civil service protection.
- A state or local government is fiscally responsible for the debts and other liabilities of the entity, including funding responsibility for benefit plans.

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- For an entity that is not a political subdivision of a state, it is delegated authority to exercise sovereign powers of state or local government, e.g., powers of taxation, eminent domain, or policing.

The draft notes that the first two factors are related and that an entity would be expected to satisfy one or the other, but not both. In addition, it says that control by state or local government cannot be a “mere legal possibility,” such as might be the case if there were multiple tiers of corporations between the entity and the state or local government.

The additional factors listed include whether the entity was created by statute, its sources of funding, the control of its operations, whether it is treated as an agency or instrumentality of government under state law or for purposes other than Code section 414(d), and whether it is treated as a governmental entity for purposes of federal employment tax or income tax. Finally, the draft says there are two factors that would indicate an entity is not governmental: (1) a party other than a state or local government or instrumentality has an ownership interest or a similar interest in the entity, or (2) it does not serve a governmental purpose. The draft includes a number of examples illustrating application of the various factors.

The IRS requests comments on the draft proposed regulations, including the ordering and application of the factors, whether the distinction between major factors and additional factors should be maintained, and whether a safe harbor based on control by a state or local government and fiscal responsibility for an entity’s debts by a state or local government should be adopted. Comments are due by February 6, 2012. The guidance says that the IRS will schedule a public hearing on these draft regulations at a later date and expects to conduct town hall style meetings throughout the country to solicit comments in advance of proposing regulations.



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