

# 2012 WESTERN BENEFITS CONFERENCE

Plans of Governments, Churches, and  
Other Tax Exempt Organizations

Scott E. Galbreath,  
J.D. , LL.M. (Tax)



CHANG RUTHENBERG & LONG PC  
EMPLOYEE BENEFITS LAWYERS

Mary Ellen Mullen, CFA  
Bridgebay Consulting, LLC  
Bellevue, WA

# Introduction: Unique Circumstances

- Different motivation from For Profit Employer
- No need for tax deduction for contributions
- No need for tax exempt trust
- Compete with private sector
- Allow tax deferral for employees

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## Government Plans



# How Are Governmental Plans Different?

- Escape most tax qualification rules
  - Nondiscrimination, coverage, cutback
- Subject to
  - 401(a)(17) limit on compensation
  - 415 limit
    - QGEBA
  - Pre-ERISA vesting rules
  - Prohibited Transaction rules that apply to private foundations
  - Rollover and RMD rules
  - Exclusive benefit and definitely determinable

# How Are Governmental Plans Different?

- Escape ERISA Title I and IV
  - No 408(b)(2) or 404(a)(5)
- Why?
  - Federalism
  - Taxing power adequate substitute for termination insurance

# Governmental Plans Practical Issues

- Adopting a pre-approved plan
- Adopting a multiemployer plan
- Adopting a multiple employer plan

# How Are Governmental Plans Different?

- Subject to State regulation
- Public Records Act
  - *Sonoma County Employees' Retirement Assn*, 2011 Cal. App. Lexis 1124 (2011)
- State fiduciary requirements
  - California constitution imposes “ERISA-like” fiduciary duties

# How Are Governmental Plans Different?

- Impairment Of Contract Doctrine
  - Federal constitution
  - Often state constitution or statute
- Types of plans available
  - No 401(k)
  - 457(b)
  - Pick up contributions
  - Social Security Replacement Plan
  - May also be eligible for 403(b) plan
  - QGEBA



# Impairment Of Contract Doctrine

- Federal and State Constitutional Prohibition
- May not enact law impairing a contractual obligation
- Three issues
  - Is there a contract?
  - Was it impaired?
  - Is the impairment unreasonable?

# California Pension Cases

- Right to pension "vests" upon employment
- Subject to conditions
- Express reservation of rights

# California Retiree Health Cases

- Contract must be found in statute or other official board action (i.e., resolution)
- Terms of the resolution may permit the employer to make changes
- Often dismissed cases that did not allege a contract thru official document
- *Retired Employees Association of Orange County (REAOC)*

# REAOC District Court

- Orange County pooled retirees with actives for health insurance premiums
- Split the pool to have them rated separately to save money
- REAOC sued alleging impairment of contractual right
- District Court granted summary judgment in favor of Orange County because no official action set forth duration of pool

# REAOC Ninth Circuit

- REAOC appealed to Ninth Circuit, alleging that there was an implied contract
- Ninth Circuit sent to California Supreme Court

# REAOC

## California Supreme Court

- Can a County enter into an implied contract to provide vested rights?
  - Yes
  - Under right circumstances
  - Implied terms of express contract
- Did not address vested right issue
- Case was remanded to District Court
- REAOC asking for summary judgment
  - Hearing was May 21

# REAOC Implications

- No longer just official action
- Governmental entities should analyze all communications
- Reservation of right to change
- Integration clause
- May apply to pension cases

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# What Is A Governmental Plan?

- Internal Revenue Code 414(d) and ERISA 3(32)
  - Established and maintained for employees by:
    - the U.S.
    - State or political subdivision
    - Any agency or instrumentality of foregoing
    - Also includes Railroad Retirement Act , International Organizations Immunity Act, and Indian Tribal Government plans

# What Is A Governmental Plan?

- Not defined under Code or ERISA
  - Political subdivision
  - Agency
  - Instrumentality

# What Is Governmental-Case Law and Regulatory Guidance

- *NLRB v. Natural Gas Utility Dist. Of Hawkins County* (U.S. Supreme Court 1971)
  - Looked at many factors in deciding what is a political subdivision.
  - Subsequently applied to agency and instrumentality in ERISA cases
- Rev. Rul. 57-128- guidance on instrumentality for purposes of exemption from employment taxes
- Rev. Rul. 89-49-guidance under Code section 414(d)

# Rev. Rul. 89-49

- Citizens organized volunteer fire department
  - A not-for-profit corporation
- Department contracted to provide fire services to municipality
- IRS ruled plan was not governmental because:
  - the degree of control by the municipality was minimal;
  - not created by legislation;
  - funds were from donations not government; and
  - Employees were not treated as public employees

# What Is A Governmental Plan?

- IRS Advance Notice of Proposed Rulemaking (ANPR) November 8, 2011
- IRS consulted with DOL and PBGC
  - Concerned about increase in requests from sponsors with increasingly remote relationships
  - Provides for a facts and circumstances test
- IRS had phone forums and town hall meetings
- Public comments were due by June 18, 2012
- Public hearing July 10, 2012

# ANPR Governmental Plan

- Established and maintained for employees
- Employer is a governmental entity
  - State and political subdivision
  - Agencies or instrumentalities
- Only participants are employees of governmental entity

# ANPR Definitions

- State is U.S. and D.C.
- Political subdivision
  - Regional, territorial or local authority created or recognized by state statute to exercise sovereign powers
    - Tax
    - Eminent domain
    - Police power
    - Governing officers must be appointed by state officials or publicly elected

# Agency Or Instrumentality Of The U.S.

- Did Congress intend it to be a federal entity?
- Factors:
  - No private interests
  - Control and supervision by federal government
  - Exempt from federal, State, and local taxes by Congress
  - Created by specific federal enabling statute
  - Receives financial assistance from U. S.
  - Federal court finds it is an agency or instrumentality of U. S.
  - Other governmental entities recognize it
  - Employees are treated like federal employees



# Federal Credit Unions

- IRS Notice 2005-58 said pending can be considered a non-governmental tax exempt organization eligible for 457(b).
  - Provided never claimed to be governmental.
- ANPR says once guidance is issued under 414(d) exception will end.

# Agency Or Instrumentality Of State Or Political Subdivision

- Facts and circumstances test
- Doesn't matter what entity calls itself
- Lists a number of factors
  - Main factors
  - Other factors
- Meeting one or more is not determinative

# Agency Or Instrumentality

## Main Factors

- Governing board is elected or controlled
- State or political subdivision has fiscal responsibility
- Employees are treated like State employees
- Has sovereign powers
  - Taxation, eminent domain, police powers

# Agency Or Instrumentality Other Factors

- Operations are controlled by State/political subdivision
- Funded by taxes or other public sources
- Created by statute prescribing purposes
- Treated as governmental entity for federal income or employment taxes or other federal laws

# Agency Or Instrumentality Other Factors

- Court has determined it is governmental entity
- Subject to State laws as agency (e.g., open meetings, public records, Attorney General representation)
- Owned by State or political subdivision and no private interests involved
- Serves a governmental function

# ANPR Comment Requests

- Major and other factors
- Safe harbor
  - Majority of board controlled or elected and
  - State or political subdivision has fiscal responsibility
- De Minimis number of employees
- Transitional relief for good faith belief

# ANPR Concerns

- All or nothing
  - De Minimis employees
  - Employers?
- Grandfathering/transition rules
- Weighing of factor
- Determination or safe harbor
  - Possible safe harbor

# Deferred Compensation

- 409A
- 457
- State and Local Governmental and Tax Exempt Organizations



# 457(b) Eligible Plans

- Allows employees to defer lesser of specific amount (2012-\$17,000) or 1/3 of compensation (not coordinated with 402(g))
- Can be employer contributions
- Allows make-up contributions in last 3 years of retirement
- Trust requirement for governments and Indian tribes
- Tax exempt organization can only cover top hat group

# Ineligible 457(f) Plans

- 457(f)- if not an eligible plan under 457 then taxed when no longer subject to a substantial risk of forfeiture
- Conditioned upon future services
- Thus, generally taxed when vested e.g., Retirement
  - Principal taxed in year of lapse of risk
  - Investment earnings when received

# 457(f) and 409A

- Notice 2007-62 substantial risk of forfeiture
  - 457(f)-conditioned upon future services of anyone
  - 409A-or condition related to purpose of compensation and substantial possibility of forfeiture
    - No rolling risk of forfeiture
    - A rationale person would not agree to subject a right to current compensation (e.g., salary) to a real possibility of forfeiture
    - End of elective 457(f) plans?
  - IRS expects future guidance to provide same definition for 457(f) as 409A

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## Church Plans



# Church Plans

- Church, convention or association, or controlled or associated tax exempt organization
  - Hospitals, schools, etc.
- Similar to governmental escape much of ERISA
  - Must meet pre-ERISA participation, coverage and vesting rules
- Can irrevocably elect ERISA coverage
- Longer correction period to fix

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Plans Of Tax  
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# 403(b) Plans

- Only available to charitable organizations and public schools
- May only invest in qualified annuity contracts or custodial accounts holding mutual funds
- May be employee deferrals or employer money
- Elective deferrals must be available to all employees earning > \$200
- Qualified plan rules apply to matching contributions

# Questions

