

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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Mullen

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Plans Of Tax
Exempt
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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

