

Government Finance Officers Association (GFOA)

National Association of State Retirement Administrators (NASRA) □

National Association of Government Defined Contribution Administrators (NAGDCA)

National Conference on Public Employee Retirement Systems (NCPERS)

National Council on Teacher Retirement (NCTR)

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Internal Revenue Service

1111 Constitution Ave., NW

Washington, DC 20224

On behalf of the above-listed national public sector associations – representing state and local government plans and sponsors – we are writing in response to the Advance Notice of Proposed Rulemaking ("ANPRM"), REG-157714-06; 76 FR 69172 (Nov. 8, 2011)), regarding the definition of governmental plan under Section 414(d) of the Internal Revenue Code of 1986 ("IRC"), as well as the related public hearing on the proposed regulations (77 FR 5442) scheduled for July 9, 2012. We appreciate the opportunity to comment and the deliberative approach both the Internal Revenue Service ("IRS") and Department of Treasury ("Treasury") have taken on this critical issue.

In addition to this comment letter, our members will be submitting comments individually regarding the impact of the draft proposed rules on existing governmental entities and plans. 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. However, "safe harbors," grandfathering treatment, and transition requirements will be paramount to ensuring the administrability of all governmental plans going forward. Thus, these areas will be the focus of our written comments.

Many of the members of our organizations maintain or participate in multiple employer governmental plans. Therefore, throughout our remarks, when we refer to establishing and maintaining a governmental plan, we are including the situation where an entity is a participating employer in a governmental multiple employer plan.

"SAFE HARBORS"

Based upon input from the members of the signatories, there is a great deal of interest in the IRS and Treasury establishing safe harbors in the final regulations. We would recommend that, if an entity satisfied any one of the following safe harbors, then for the purposes of IRC Section 414(d), the entity could establish and maintain a governmental plan for its employees

and/or could participate in a multiple employer governmental plan without consideration of any other factors:

- **Fiscal Responsibility Safe Harbor**—A State or political subdivision has fiscal responsibility for the general debts and other liabilities of the entity, including employee benefit plans.

This is a safe harbor that was described in the ANPRM (76 FR 69183). We would understand that this safe harbor would require general fiscal responsibility – so that the safe harbor would not be failed if the entity had other sources of funding.

- **Elected Board Safe Harbor**—A majority of the members of the governing board of the entity are either controlled by a State or political subdivision thereof, including the power to appoint and/or remove a majority of the governing body, or are elected through periodic, publicly-held elections by the voters.

This is also a safe harbor described in the ANPRM (76 FR 69183).

- **Sovereign Powers Safe Harbor**—The entity has been delegated one or more sovereign powers of a state or a political subdivision thereof.

The definition of sovereign powers would include taxation, police, eminent domain, but would also include sovereign powers as defined by the state constitution.

- **Government Agent Safe Harbor**—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.
- **Federal Tax Safe Harbor**—The 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.

If an entity meets any of the following criteria regarding Federal income or employment tax treatment, the entity should be treated as a governmental agency or instrumentality:

1. The entity is covered by a Section 218 agreement or a modification to such agreement.
 2. The entity has the authority to issue tax-exempt bonds under IRC Section 103(a).
 3. The entity has a Section 115 ruling.
- **Federal Law Safe Harbor**—The entity has been treated as the agency or instrumentality of a state or political subdivision pursuant to a federal law (other than the IRC) or a federal agency (other than the IRS and Treasury).

We believe that consistency of treatment across federal agencies is important in this respect.

- **Court Ruling Safe Harbor -- A state or federal court has determined that the entity is 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.

GRANDFATHER TREATMENT

When the regulations are final, it will be very important for the regulations to provide grandfather treatment for certain entities and their employees who are participants in governmental plans, where the entities do 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 they deem fit. In this regard, we would suggest that the following entities be grandfathered 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:

1. An entity with a favorable private letter ruling under Rev. Rul. 89-49 or Rev. Rul. 57-128.
2. 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.
3. 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.

TRANSITION PROVISIONS

We believe that there are two types of transition provisions that should be considered. The first is the transition time that would be needed for plan document changes and/or state

legislative changes; the second is the type of transition that is necessary when an entity changes its status.

Transition for Plan Document Changes

When the regulations are finalized and governmental plans are required to make plan document changes, we recommend that the time period for making plan document changes recognize that many governmental plans must be amended by action of the state legislature. We would ask that the effective date allow for implementation in a manner similar to the approach taken in Notice 2012-29 regarding the normal retirement age regulations.

Transition for Entity Status Changes – On-going

Once the regulations are final, we believe that there will be an on-going need for transitional provisions. We recommend that flexibility be allowed under the regulations so that, 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 could be, but would not be required to be, allowed to remain in the governmental plan.

ADMINISTRATIVE CONSIDERATIONS

Multiple Employer Plans – Reasonable Procedures

Many of the entities represented by the signatories to this letter are the administrators of or the participating employers in multiple employer governmental plans. The number of participating employers can be in the thousands. The regulations should make it clear that, if a multiple employer governmental plan has reasonable procedures in place to determine whether a participating employer is a governmental agency on instrumentality, 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. We believe that a similar approach should be taken with respect to the determination of employee status. A multiple employer governmental plan that reasonably relies on the participating employer's representation as to the eligibility of participating employees should not have the plan's governmental status jeopardized if the employer has mis-reported an individual's employment status. In these cases, EPCRS would be available for a correction and for the preservation of qualified governmental plan status.

Affected Employees – Rollovers Allowed

Where a correction is needed and employees are not allowed to participate in a governmental plan because they are not governmental employees, we believe that 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 that we encounter, 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.

De Minimis Participation

The IRS and Treasury specifically asked for comment as to the necessity for a de minimis standard under IRC Section 414(d). We think it is important to distinguish between a prospective standard that would allow a governmental plan to cover a de minimis number of non-governmental employees in the future and the reasonable grandfather standards and reasonable transitions standards that are proposed in this letter. We do not believe that prospective de minimis standards would 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.

Expedited Ruling Procedure

We understand that, even with the clarity that will be provided by 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, with a reduced fee. The current fees for private letter rulings would 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.

Determination Letter Applications

The IRS may wish to consider creating a checklist to be used for governmental plan status as part of the determination letter process. This could be similar to the approach the IRS has taken with regard to pick-ups and 401(h) accounts. The checklist could include the safe harbors and also the entire list of factors as they finally emerge.

We appreciate very much the opportunity to comment on the ANPRM and look forward to providing testimony on this very significant issue. If you have any questions, please do not hesitate to contact the following representatives of our organizations:

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