



Agenda Item 12

February 20, 2013

ITEM NAME: Implementation of IRS Proposed Draft Regulations for Public Agency Determinations

PROGRAM: Customer Account Services Division

ITEM TYPE: Information

EXECUTIVE SUMMARY

The California Public Employees' Retirement System (CalPERS) is a governmental pension plan under the authority of section 414(d) of the Internal Revenue Code (IRC). This section establishes some of the criteria that an entity must meet in order to qualify to contract for CalPERS governmental plans (the "CalPERS Plans"). The Internal Revenue Service (IRS) and the Treasury Department have issued an advance notice of proposed rulemaking that reviews the scope of existing law and provides proposed draft regulations (Proposed Draft Regulations) pursuant to IRC section 414(d). A multi-divisional CalPERS workgroup analyzed the Proposed Draft Regulations and developed updated guidelines for staff to use for making eligibility determinations. Detailed information will also be made available to employers via Circular Letters and the CalPERS website.

STRATEGIC PLAN

This informational item supports Strategic Plan Goal B to deliver superior, end to end customer service that is adaptive to customer needs and actively manage business risks with an enterprise-wide view. The Customer Account Services Division (CASD) will develop and implement standardized policies and procedures that ensure compliance with applicable state and federal statutes and regulations, mitigate risk, improve operational effectiveness and enhance customer service delivery.

BACKGROUND

Section 414(d) of the IRC defines the term "governmental plan" as a plan established and maintained for its employees by the government of the United States, the government of any State or political subdivision thereof, or by any of their agencies or instrumentalities. As a governmental plan within the meaning of IRC section 414(d), CalPERS will be subject to any final regulations that the IRS adopts interpreting section 414(d). Ultimately what this means is that CalPERS will have to prohibit participation of any entity in the CalPERS Plan that does not meet the requirements set forth in any such final regulations.

The Proposed Draft Regulations provide a framework for determining whether an entity is an “agency or instrumentality of a State or a political subdivision of a State.”

This framework also includes evaluation criteria which the IRS has combined into two groupings. The first group consists of the following five factors that are categorized as “major factors:”

- The entity’s governing board or body is controlled by a State or political subdivision thereof;
- The members of the governing board or body are publicly nominated and elected;
- A State (or political subdivision thereof) has fiscal responsibility for the general debts and other liabilities of the entity (including funding responsibility for the employee benefits under the entity’s plan);
- The entity’s employees are treated in the same manner as employees of the State (or political subdivision thereof) for purposes other than providing employee benefits (for example, the entity’s employees are granted civil service protection); and,
- In the case of an entity that is not a political subdivision, the entity is delegated, pursuant to a statute of a State or political subdivision, the authority to exercise sovereign powers of the State or political subdivision (such as, the power of taxation, the power of eminent domain, and the police power).

The second group contains the following eight factors that have been categorized as “other factors:”

- The entity’s operations are controlled by a State (or political subdivision thereof);
- The entity is directly funded through tax revenues or other public sources;
- The entity is created by a State government or political subdivision of a State pursuant to a specific enabling statute that prescribes the purposes, powers, and manners in which the entity is to be established and operated;
- The entity is treated as a governmental entity for Federal employment tax or income tax purposes (such as, the authority to issue tax-exempt bonds under section 103(a)) or under other Federal laws;
- The entity is determined to be an agency or instrumentality of the State (or political subdivision thereof) for purposes of State laws;
- The entity is determined to be an agency or instrumentality of a State (or political subdivision thereof) by a State or Federal court;
- A State (or political subdivision thereof) has the ownership interest in the entity and no private interests are involved; and,
- The entity serves a governmental purpose.

ANALYSIS

The Proposed Draft Regulations do have an impact on our current contract processes and the administration of many of CalPERS existing programs and services. In recognition of this fact, a multi-divisional workgroup was established to review the criteria, assess the potential impacts of each, and make recommendations as to how the criteria should be applied to existing, as well as, prospective new agencies.

We recognize that the Proposed Draft Regulations are not final, and could be revised during the official regulatory process, which could span several years. However, in order to mitigate potential risks to the System, its members and employers, we have decided to begin utilizing the Proposed Draft Regulations when determining whether a prospective new agency can contract with CalPERS. We have begun to align our employer contracting process with the Proposed Draft Regulations.

Information regarding the Proposed Draft Regulations will be communicated to our stakeholders via the CalPERS website and Circular Letter communications. Our communication strategies will include targeted outreach efforts to our school employers to assist them with their unique parameters in applying these regulations. These communications will further provide both existing and prospective public agencies with detailed information outlining the IRC criteria, as well as, the specific information that CalPERS requires in order to review an entity's eligibility to participate in the CalPERS Plans.

We will develop an ongoing communication plan covering internal and external communications and will ensure that any future changes to the Proposed Draft Regulations are communicated timely to key stakeholders.

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