



Pension & Health Benefits Committee

California Public Employees' Retirement System

Agenda Item 10

December 17, 2013

ITEM NAME: Implementation of IRS Governmental Plan Guidance

PROGRAM: Customer Account Services Division

ITEM TYPE: Information

EXECUTIVE SUMMARY

The California Public Employees' Retirement System (CalPERS) is a governmental pension plan under section 414(d) of the Internal Revenue Code (IRC).

In February 2013, Customer Account Services Division (CASD) provided the Pension and Health Benefits Committee with an informational update on Internal Revenue Service (IRS) guidance regarding the definition of a governmental plan under section 414(d) of the IRC and staff's incorporation of this guidance into CalPERS existing review process for new applications from agencies seeking to participate in the CalPERS plan. Today's informational agenda item will provide the Board an update on this implementation.

STRATEGIC PLAN

This informational item supports the CalPERS Strategic Plan Goal A to improve long term pension and health benefit sustainability. CASD has developed and implemented policies and procedures that will better promote compliance with applicable State and federal statutes and regulations to mitigate risk, improve operational effectiveness, and enhance customer service delivery.

BACKGROUND

IRC section 414(d) 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. In November 2011, the IRS and the Treasury Department issued advance notice of proposed rulemaking (ANPRM) to solicit feedback regarding draft proposed regulations that would provide a comprehensive "facts and circumstances" test for a governmental plan to determine whether an entity is eligible to participate in the plan. Specifically, the test provides guidance on determining whether an entity is an "agency or instrumentality of a State or political subdivision of State" for the purpose of IRC section 414(d).

Noting an historical lack of comprehensive guidance in this area, the IRS drew upon its earlier governmental entity rulings, dating back to the 1950s, to create a "facts and circumstances" test comprised of two categories: "Major Factors" and "Other Factors". The Major Factors include such considerations as the composition of the

entity's governing board (i.e. who controls the Board and how members are nominated and elected), who bears fiscal responsibility for the debts and other obligations of the entity, whether the entity's employees are treated in the same manner as civil service employees (for purposes other than providing employee benefits), and the entity's authority to exercise sovereign powers of the State such as the powers of taxation and eminent domain. The Other Factors include items such as whether public or private sources fund the entity, whether the entity is established by the State pursuant to a specific enabling statute, whether it is treated as a governmental entity for federal tax purposes, whether the entity has any private interests, and whether the entity serves a governmental purpose.

While the guidance includes the evaluation of several factors, unfortunately no factors are determinative, nor is there any specific number of factors in each category that must be met in order for an entity to be eligible to participate in a governmental plan.

Although the draft proposed IRC 414(d) regulations are not final, and final adoption of the guidance could take several years, the ANPRM are drawn on past IRS guidance and related statements by IRS officials strongly suggest that they reflect **current tax law** in this area. Moreover, the IRS has made clear that the inclusion of even a single non-governmental entity could jeopardize the governmental plan status of CalPERS. Accordingly, in order to mitigate potential risks to the System, our members and employers, we have begun to incorporate the IRS guidance into our eligibility review process for prospective new agencies that wish to participate in CalPERS plans.

ANALYSIS

After reviewing existing contract processes within CASD's contract services unit, CASD coordinated with the CalPERS Legal Office and a cross-divisional team to establish a new prospective agency contract process with increased focus on the section 414(d) criteria set forth in the IRS "facts and circumstances" test. Staff communicated the revisions to the review process to stakeholders through two Circular Letters (Attachments A and B). The analysis is by no means simple nor a bright line test and it involves the review of many complex issues and related documents. The New Applicant questionnaire (Attachment B) and review process is intended to help elicit the information necessary to make these determinations.

The CASD has received 98 CalPERS plan contract requests that have been or are currently being reviewed through our updated contract process. These requests are from a variety of public agencies and charter schools. To date we have approved fifteen agencies for participation in the CalPERS plans (ten public agencies and five charter schools). We have denied sixteen agencies (seven public agencies and nine charter schools). This latter group is comprised of entities that have not sufficiently demonstrated that they are an agency or instrumentality of the state or a political subdivision of the state within the meaning of section IRC 414(d). Another twenty-two agencies have either cancelled or were non responsive to staff outreach efforts to

continue their respective contract requests. Staff continues to review the remaining forty-five contract requests.

We have received six appeals from agencies whose requests were denied (one public agency, which later withdrew the appeal, and five charter schools).

In addition to the two Circular letters, communication efforts on the new contract review process have included the February 2013 Board Agenda item and CalPERS website updates. Presentations were also made at the October 2013 Employer Educational Forum and at the quarterly School Employer Advisory Committee meetings.

ATTACHMENTS

Attachment A – Circular Letter - Internal Revenue Service Advance Notice of Proposed Rulemaking Regarding Definition of a Governmental Plan

Attachment B – Circular Letter – New Applicant Questionnaire for Entities Requesting to Participate in CalPERS Benefit Plans

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