



December 15, 2011

IRS Advance Notice of Proposed Rulemaking: Determination of Governmental Plan Status

Executive Summary

- The Internal Revenue Services (IRS) has issued an advance notice of proposed rulemaking (ANPR) as the first step to issuing regulations under § 414(d) of the Internal Revenue Code (Code) to define the term “governmental plan,” which would include employee plans established by: (1) the U.S. government; (2) an agency of the government; or (3) a “governmental instrumentality.”
- The ANPR describes the rules that the IRS is considering proposing that relate to the determination of whether a plan is a governmental plan within the meaning of § 414(d), and includes several proposed factors that would be considered in making that determination. As proposed in the ANPR, credit unions would not be considered “governmental instrumentalities” and, therefore, would be permitted to continue offering non-governmental plans, such as under §§ 403(b) and 457 of the Code.
- The ANPR also contains an appendix that includes a draft notice of proposed rulemaking on which the IRS seeks public comment.
- The IRS is accepting public comments on the ANPR until February 6, 2012. **Please send your comments to CUNA by January 16.**

Please send comments to Senior Vice President and Deputy General Counsel [Mary Dunn](#) and Assistant General Counsel [Luke Martone](#), or contact us at (800) 356-9655 ext. 6733. [Click here](#) for the *Federal Register* notice.

Background

The ANPR describes rules that the IRS is considering proposing and includes a draft proposed rule under § 414(d) of the Code. The ANPR seeks to establish rules that would provide general guidance relating to the determination of whether a retirement plan is a “governmental plan” within the meaning of § 414(d). As noted in the ANPR, it is expected that the principles set forth in these rules would generally also apply for purposes of §§ 403(b) and 457 of the Code. Currently, there are no regulations interpreting § 414(d).

Section 414(d) of the Code provides that the term “governmental plan” generally means a plan established and maintained for its employees by: (1) the U.S. government; (2) an agency of the government; or (3) a “governmental instrumentality.” The ANPR includes a proposed regulation that would, among other things, establish a test for determining whether an employer is a “governmental instrumentality” for purposes of § 414(d).

IRS Private Letter Ruling

In 2004, the IRS issued a private letter ruling in response to an inquiry from a federal credit union (FCU) as to the permissibility of the FCU establishing a “nonqualified deferred compensation plan described in § 457(b) of the Code” (§ 457 Plan). The private letter (LTR 200430013)—which applies only to the letter’s recipient—stated that:

Section 457 of the Code is inapplicable to the nonqualified deferred compensation plan that the FCU proposes to establish for the benefit of its executives, because the FCU is a federal governmental instrumentality described in § 501(c)(1)(A) of the Code and does not constitute an eligible employer under § 457(e)(1)(A) or (B).

Essentially, the letter concluded that the FCU was not permitted to offer a § 457 Plan because as a “governmental instrumentality,” the FCU is not eligible to offer a 457 Plan.

IRS Notice Regarding Section 457 Plans Offered by FCUs

In 2005, the IRS revisited the issue addressed in its 2004 private letter ruling with issuance of Notice 2005-58. In the Notice, the IRS stated that FCUs would be permitted to maintain § 457 Plans in effect on August 15, 2005. The Notice indicated that the IRS would be issuing official guidance regarding the definition of a “governmental plan” under § 414(d); this ANPR is the first step in the IRS’s efforts to publish such guidance.

Description of the ANPR and Draft Notice of Proposed Rulemaking

According to the ANPR, a “governmental plan” would be a plan established and maintained for its employees by the government, an agency of the government or a “governmental instrumentality.”

Facts and Circumstances Test

The ANPR includes a proposed facts and circumstances test that would be used to determine whether an entity is an agency or governmental instrumentality. The facts and circumstances test would focus on the degree to which the entity is connected with the federal government and would require the following factors be considered:

- The entity performs or assists in the performance of a governmental function.
- There are no private interests involved, or the government has all of the powers and interests of an owner.
- The control and supervision of the entity is vested in the government—control must be more than the government’s extensive federal regulation of an industry.
- The entity is exempt from federal, state, and local tax by an Act of Congress.
- The entity is created by the U.S. government pursuant to a specific enabling statute that prescribes the purposes, powers, and manner in which the entity is to be established and operated.
- The entity receives financial assistance from the government.
- Other governmental entities recognize and rely on the entity as an arm of the government.

- The entity’s employees are treated in the same manner as federal employees for purposes other than providing employee benefits.

FCU Illustrative Example of Application of the Facts and Circumstances Test

The ANPR’s proposed regulations include an example to illustrate the application of the facts and circumstances test to a particular entity—a FCU. As noted above, one purpose of the ANPR is to address whether a FCU is a governmental instrumentality for purposes of determining whether the FCU can maintain an eligible nonqualified deferred compensation plan, as described in the IRS Notice. The proposed example concludes that FCUs are not governmental instrumentalities based on the facts and circumstances test.

Specifically, proposed § 1.414(d)(3) would include the following example to illustrate the facts and circumstances test:

(i) *Facts.* Entity A is a FCU, which is created pursuant to the FCU Act, and is a tax-exempt organization under § 501(c)(1)(A)(i). Membership in the FCU is not open to the general public but to individuals who share a common bond, current or former employees of specified employers. Entity A is member-owned and is controlled by a board of directors that is elected by its membership. Entity A, along with other FCUs, is subject to regulation by NCUA, which is a federal agency that charters and regulates FCUs.

(ii) *Conclusion.* Based on the facts and circumstances and the factors in paragraph (c)(2) of this section, Entity A is not an agency or instrumentality of the U.S. because its board of directors is elected by its own members and the directors are not responsible to the U.S., except to the limited extent set forth in the FCU Act and regulated by NCUA. Thus, Entity A is not a governmental entity within the meaning of paragraph (c) of this section.

The IRS Notice (discussed above) states that the guidance in the Notice is applicable until the IRS issues further guidance related to FCUs’ status as governmental instrumentalities. The proposal’s supplementary information indicates that upon final regulations on this issue are adopted, the guidance for FCUs included in the IRS Notice will no longer apply. However, after issuance of final regulations, FCUs can be considered eligible employers in regard to § 457 Plans on the basis that FCUs are non-governmental tax-exempt organizations.

Application of Section 414(d)

The proposed regulations are only applicable for purposes of § 414(d), and not for any other purpose under the Code. However, the proposal’s supplementary information states that “[i]t is expected that the principles set forth in these regulations would generally also apply for purposes of sections 403(b) and 457.”

Questions Regarding the ANPR & Draft Notice of Proposed Rulemaking

1) Do you agree with the IRS that FCUs are “eligible employers” (non-governmental employers)?

2) Do you agree with the proposed example in the ANPR that would be included in the proposal that concludes an FCU is an “eligible employer”? Whether or not you agree with its inclusion, please specify why you support or oppose the FCU example.

3) Does your FCU offer § 457 plans? Whether or not, has the uncertainty in this area impacted your offering such plans?

4) Under the ANPR, whether an entity is an agency or instrumentality of the U.S. is based on the facts and circumstances enumerated in the proposal. Do you agree with the proposed use of a “facts and circumstance” test to determine whether an entity is a governmental instrumentality?

5) Any other questions or comments.
