



Definition of “Governmental” Employer

How the IRS might propose to determine whether an employer is a “governmental” employer under its possible regulation interpreting IRC §414(d).

The views expressed in this presentation are solely those of the author and do not necessarily represent the views of his System.

The Statute Has Three Buckets

- The Government of any State.
- Any Political Subdivision of any State.
- Any Agency or Instrumentality of a State or of a Political Subdivision of a State.

First Bucket - State

What is a “State”?

IRS Answer: **A “State” is a State.**

No Tests.

No Examples.

Second Bucket – Political Subdivision

What is a “Political Subdivision” of a “State”?

IRS Answer: **There will be test on this.**

No examples.

Second Bucket – Political Subdivision – The Test

- Regional, territorial or local authority
- Created or recognized by state statute
- To exercise sovereign powers
- Which powers generally are the power of taxation, the power of eminent domain, and the police power and
- The governing officers are either appointed by State officials or publicly elected.

Third Bucket – Agency or Instrumentality

What is an “Agency” or “Instrumentality”?

IRS Answer: **There will be a facts and circumstances test on this.**

Lots of examples.

Third Bucket – Agency or Instrumentality – The Test

Possible “Main” Factors:

- Entity delegated to exercise sovereign powers by State statute or PS ordinance
- State or PS control entity’s governing board
- Members of governing board are publicly nominated and elected
- State or PS has fiscal responsibility
- Entity’s employees are treated in same manner as employees of State or PS

Third Bucket – Agency or Instrumentality – The Test

Possible “Other” Factors:

- Entity created by specific enabling statute of State or PS
- State or PS “controls” entity’s operations
- Entity is directly funded by tax revenues or other public sources
- Entity treated as governmental entity for other federal tax purposes

Third Bucket – Agency or Instrumentality – The Test

More Possible “Other” Factors:

- Entity determined to be agency/instrumentality of the State or PS for purposes of State law
- Entity determined to be agency/instrumentality by courts
- State or PS has ownership interests and no private interests are involved
- Entity serves governmental purpose

So What Is The IRS Up To?

- The problem as IRS (and DOL/PBGC) sees it is with entities seeking to be called “governmental” employers, notwithstanding “increasingly remote” relationships with a State/PS.
- IRS wants to hear from us about its possible facts and circumstances test for the third bucket.
- Not clear that the IRS wants to hear from us on tests for first two buckets.

Is There a Problem with This?

Other tests can be propounded.

Courts, for example, have been using what might appear to be a looser test for “political subdivision” when interpreting the ERISA parallel to IRC §414(d).

Under that test, an entity is a “political subdivision” if it is either

- created directly by the state, so as to constitute a department or administrative arm of a government, or
- administered by individuals who are responsible to public officials or to the general electorate.

Courts' Test for "Political Subdivision"

- *Rose v. Long Island Railroad Pension Plan*, 828 F.2d 910 (2d Cir. 1987) – Metropolitan Transportation Authority is a political subdivision.
- *Shannon v. Shannon*, 965 F.2d 542 (7th Cir. 1992) – West Allis Memorial Hospital, Inc. is not a political subdivision.
- *Koval v. Washington County Redevelopment Authority*, 574 F.3d 238 (3d Cir. 2009) – Authority is a political subdivision.

Initial Plan of Action

- Gather together a definitive list of employers whose employees benefit from your fund.
- Determine whether each employer is created or exists pursuant to specific statutory authorization.
- Consider whether and where each employer fits in the IRS' possible analytic scheme.
- Consider whether definition(s) putatively rejected by IRS provide different/clearer result.
- Make a list of your questions/concerns.

Some Possible Questions for Teacher Systems

- Are you sure school districts would be considered “political subdivisions” under the IRS’ test for the second bucket? Would it matter if school districts wound up in third bucket?
- Where would your charter schools fit in and would they pass the test applicable to them?
- Do you have employers whose status might be problematic under the IRS’ tests?

Some Possible Questions for Teacher Systems

- Would you favor one or more different tests, such as the two alternatives “political subdivision” test used by the courts?
- Or do you feel it is high time the IRS cracked down on what are really private sector employers which make flaky arguments that they should be considered “governmental” employers for the purposes of IRC §414(d)?

Other Thoughts

- De minimis and transition rules will be critical if you have employers which might fail the IRS tests.
- De minimis rules may also be important, for example, because employers sometimes try to sneak in or inadvertently report private employees as their employees.