

## **Tax Issues: Old and New**

**by Robert D. Klausner**

In the midst of continuing constitutional battles, significant issues with the tax status of the public plans remain unresolved. A recent Private Letter ruling on rehiring of retirees and the continuing debate on what is “normal retirement age” should remain on the watch list of all retirement plans.

### **IRS ADDRESSES RETIRE/REHIRE POLICY IN PRIVATE LETTER RULING**

In a private letter ruling published on November 25, 2011, the IRS addressed the retire/rehire technique employed by some pension plans whereby an employee retires on one day in order to qualify for a particular retirement benefit and is then rehired to the same or a similar position shortly thereafter. The situation described in PLR 201147038 deals with a plan qualified under IRC '401(a), that, because of funding shortfalls, was required to create a rehabilitation plan under IRC '432. As part of this rehabilitation plan, the employer was forced to eliminate certain early retirement benefits. Because the rehabilitation plan would eliminate certain early retirement benefits, the employer proposed allowing certain long term employees to retire before the rehabilitation plan was put into effect, qualify for early retirement benefits, then be rehired in the same position the very next day.

The IRS examined the proposed actions and concluded that employees who “retire” in order to qualify for a benefit, with an explicit understanding between employee and employer that the employee is not separating from service with the employer, are not legitimately “retired.” Accordingly, because these employees would not actually be separating from service and would be continuing to perform services for the employer, these “retirements” would not constitute a legitimate basis to allow the employees to qualify for retirement benefits under the plan. Such “retirements” would violate IRC '401(a) and would result in disqualification of the plan under IRC '401(a).

This issue may also be tied to the still unresolved issue of “normal retirement age” regulations being applied to public plans which use service as a qualification for retirement.

## **II. DEFINITION OF “GOVERNMENTAL PLAN” UNDER IRC '414(d)**

On November 8, 2011, the IRS issued an advance notice of proposed rulemaking on the definition of “governmental plan” under IRC '414(d). By issuing this notice, the IRS is requesting input from the governmental community in order to supply comprehensive guidance that is practical and administrable. According to the notice, the IRS is considering the following main facts and circumstances to determine whether an entity’s employees are eligible to participate in a governmental plan:

- A. The entity’s governing board or body is controlled by a state or political subdivision. The members of the entity’s governing board or body are publicly nominated or elected.
- B. A state or political subdivision has fiscal responsibility for the general debts and other liabilities of the entity, including the responsibility for the funding of benefits under the entity's employee benefits plans.
- C. The entity’s employees are treated in the same manner as employees of the state or political subdivision for purposes other than providing employee benefits.
- D. The entity is designated the authority to exercise sovereign powers, which generally means the power of taxation, eminent domain or police power.

The proposed rules have posed potential issues for charter schools, particularly those run by for-profit entities; hospitals that are affiliated with non-profit or religious entities but which are deemed public hospitals; and joint operating agreements among utilities which are partnerships between public entities and shareholder-owned companies.

Additional concerns have been raised about “creeping federalism” in which the federal government actually exercises control over the design and management of state and local plans through the use of tax qualification rules and legislation.

The IRS held a series of town hall meetings, phone conferences and public hearings. Comments were due on the proposed rule by June 18<sup>th</sup>. Public hearings are scheduled for July 9<sup>th</sup> in Washington, DC. Details are available on the IRS website.

Our office, working with NCPERS and other pension trade associations helped develop comprehensive comments on the proposed rule.

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