STATE ADMINISTRATION
Exhibit No. 2
Date SB 229
Bill No. 2-7-2011

2011 Legislative Session
House State Administration
February 7, 2011
Melanie Symons, Chief Legal Counsel
Montana Public Employees' Retirement Board

SB 229

Informational Testimony before the
Senate State Administration Committee
February 7, 2011

- The Public Employees' Retirement System (PERS) is a qualified governmental retirement plan under Internal Revenue Code Sections 401(a) and 414(d).

- That status ensures PERS's exemption from many Code requirements, including ERISA; and affords a deferred-tax status on the contributions into the retirement plans.

- In order to maintain a qualified status, only governmental entities can participate in PERS.

- The federal Pension Protection Act of 2006 extended participation in governmental plans to Indian Tribal Governments.

- In order to maintain PERS's qualified status, we must ensure the legal entity created under the State-Tribal Cooperative Agreements Act is an instrumentality of state or local government or an Indian Tribal Government entity.

- According to the Attorney General's office, most agreements under that act do not create a legal entity. Currently there are two such legal entities:
  - *The Cooperative Management Entity that will run the Flathead Indian Irrigation Project
  - *A joint board that manages bird hunting and fishing on the Flathead Indian Reservation

- However, the broad nature of this bill does not preclude PERS membership by any other legal entity created under the State-Tribal Cooperative Agreements Act in the future.

- Additionally, federal Code also requires that the services reported to the retirement system be related to "essential governmental functions" and not "commercial" in nature.

- Generally legislation that significantly changes the terms of or membership in a governmental retirement plan includes a provision that the change does not become effective until approved by the IRS.

- The Treasury is currently working with the Department of Labor and the Pension Benefit Guaranty Corporation on issues related to the definition of a governmental plan.

- That project will delay the IRS's consideration of this legislation.

- If the legislature does not wish to wait for a ruling from the IRS, the Public Employees' Retirement Board requests a provision stating that the legislation will become void if the IRS does not approve the change.

- Finally, the Retirement Board believes that Title 19, chapter 3, part two should be amended to include these legal entities. Currently, that part addresses contracts between PERS and local governments only and is not easily transferable to contracts between PERS and State-Tribal Cooperative Agreement legal entities.

Thank you.

ICE MILLER LLP
LEGAL COUNSEL

January 18, 2011

WRITER'S DIRECT NUMBER: (317) 236-2413
DIRECT FAX: (317) 592-4616
INTERNET: BRAITMAN@ICEMILLER.COM

WRITER'S DIRECT NUMBER: (317) 236-2110
DIRECT FAX: (317) 592-4713
INTERNET: TERRY.MUMFORD@ICEMILLER.COM

WRITER'S DIRECT NUMBER: (317) 236-2468
DIRECT FAX: (317) 592-4702
INTERNET: KATRINA.CLINGERMAN@ICEMILLER.COM

VIA ELECTRONIC MAIL

Ms. Melanie Symons
Legal Counsel
Montana Public Employee Retirement Administration
100 N. Park Avenue, Suite 200
Helena, MT 59601

Re: LC 1526 – "An Act Authorizing Separate Legal Entities Created Under the State-Tribal Cooperative Agreements Act to Contract with the Public Employee's Retirement Board to Provide Retirement System Coverage for Employees of the Legal Entity"

Dear Melanie:

Per your request (January 13, 2011), we have reviewed LC 1526 to consider its impact on the Public Employees' Retirement System ("PERS"). The PERS defined benefit and defined contribution plans administered by Montana PERA are qualified governmental plans under Internal Revenue Code Sections 401(a) and 414(d). A governmental plan is exempted from many Code provisions and is also benefited by many favorable Code and regulatory provisions.

BACKGROUND

To maintain this status, only governmental entities may be participating employers in the PERS and only their employees may be participating employees. Code Section 414(d) defines a governmental plan as

> a plan that is established and maintained for its employees ... by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. **** The term "governmental plan" includes a plan which is established and maintained by an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), or an agency or instrumentality of either, and all of the participants of which are employees of such entity substantially all of whose services as such an employee are in the performance of essential governmental functions but not in the performance of commercial activities (whether or not an essential government function).

Under this definition, an Indian tribal government ("ITG") or a subdivision of that government, or an instrumentality of either, may establish and maintain a governmental plan for its employees so long as those employees perform essential government functions and not commercial activities. The inclusion of ITGs in the definition of governmental plans was accomplished by the Pension Protection Act of 2006 ("PPA"). Prior to PPA, the Internal Revenue Service ("IRS") had issued private letter rulings on this topic, which had (in limited circumstances) permitted ITG law enforcement officers to participate in a state pension plan if those law enforcement officers were subject to a mutual aid agreement, were under the supervision of state and/or local government law enforcement authorities, and were subject to state training standards.

The IRS, the Department of Labor ("DOL"), and the Pension Benefit Guaranty Corporation ("PBGC") are engaged in a guidance project to define what is a governmental employer with respect to state and local government and also with respect to ITGs. The IRS has also solicited comments with respect to the definition of "essential governmental functions" for ITG employees. While this guidance project is pending, none of the three agencies are issuing rulings or opinions with respect to governmental plan status. The timeline for the completion of that project is uncertain, but we do not expect for the ruling program to be re-opened for sometime.

ANALYSIS

LC 1526 is only applicable to a separate legal entity that is created under the State-Tribal Cooperative Agreements Act. Therefore, the question that would be raised is whether such a separate legal entity would be considered an instrumentality of state or local government or an ITG instrumentality for purposes of Code Section 414(d). LC 1526 would not seem to address the participation of the ITGs themselves, their subdivisions, or any other instrumentality. ***Notes***: (1) The PPA definition of ITG may only extend to a federally recognized tribe. If the Little Shell Chippewa tribe has not been federally recognized, then they can not fall within the coverage of Code Section 414(d). (2) Also, a separate legal entity would not be covered by the PPA definition if it engaged in commercial activities.

You have asked whether it would be reasonable to make the implementation of LC 1526 (if enacted) contingent on obtaining IRS approval for participation by such a separate legal entity. We do believe that that is a reasonable approach. In that regard, we would advise that Section 1 of the legislation be amended to read as follows:

> A separate legal entity created and authorized under this part may contract with the public employee's retirement board as provided in Title 19, chapter 3, part 2, to become a contracting employer in the public employees' retirement system, <u>subject to the determination of the Internal Revenue Service that such contract does not adversely affect the status of the system as a qualified governmental plan under Internal Revenue Code Sections 401(a) and 414(d)</u>.

We do have a concern about timing – the current guidance project is on an indefinite timetable. It could be more than a year before the IRS would accept a private letter ruling

request on this topic. We want to make sure that the proponents of the legislation are aware of this.

You have also asked whether it would be reasonable to open up the legislation to cover ITGs and their subdivisions and instrumentalities as would be permitted under the PPA. We believe that would also be a reasonable approach because it would be in keeping with the intent of the PPA. However, the same timing issues would apply if IRS approval was sought for those employers.

We wanted to make you aware of one retirement system – the Municipal Employees Retirement System of Michigan ("MERS") – which does permit ITGs to participate in their retirement system with respect to their governmental employees. (There are some other systems that also allow this participation.) To date the ITGs have focused on law enforcement employees of the tribes themselves, so they have not addressed the issue of ITG subdivisions or instrumentalities or of commercial activities. If that approach were taken in the legislation (i.e., broadening it to include any entity covered by Code Section 414(d)), would it make sense to permit participation in more than just PERS, but also include other systems? Of further interest to you and the authors might be that MERS also sponsors a volume submitter non-governmental defined contribution and non-governmental defined benefit program for the ITG enterprise employees who engage in commercial activities.

Please let us know if this letter responds to your inquiry.

Very truly yours,

ICE MILLER LLP

Mary Beth Braitman

Mary Beth Braitman

Terry A.M. Mumford

Terry A.M. Mumford

Katrina M. Clingerman

Katrina M. Clingerman

CIRCULAR 230 DISCLOSURE

Except to the extent that this advice concerns the qualification of any qualified plan, to ensure compliance with recently-enacted U.S. Treasury Department Regulations, we are now required to advise you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including any attachments, is not intended or written by us to be used, and cannot be used, by anyone for the purpose of avoiding federal tax penalties that may be imposed by the federal government or for promoting, marketing, or recommending to another party any tax-related matters addressed herein.