The following is a summary of 2012 Federal legislative and regulatory activity of interest to public plans. Only the sections referring to tax reform reflect 2013 activity. Subjects covered, in order of their appearance, are as follows:

- **Public Employee Pension Transparency Act (PEPTA)**
- **Congressional Reports on Public Pension Issues**
- **GPO/WEP Repeal**
- **Mandatory Social Security**
- **Tax Reform**
  - **JCT Cost Estimates of Retirement Savings Tax Incentives**
  - **Bipartisan Tax Reform Working Group on Pensions/Retirement Created**
- **Normal Retirement Age Regulations**
- **Definition of a Governmental Plan ANPRM**
- **Treatment of "Picked-Up" Contributions**
- **Rule to Treat Certain Public Pension Trustees as Municipal Advisors**
- **Changes to the SSA Death Master File**

U.S. CONGRESS

Public Employee Pension Transparency Act (PEPTA): The PEPTA legislation was introduced in the House of Representatives as HR 567 by Congressman Devin Nunes (R-CA) on February 9, 2011; in the Senate, an identical bill, S 347, was introduced by Senator Richard Burr (R-NC) on February 15, 2011. Since each Congress covers two calendar years, PEPTA was still a pending piece of legislation in 2012.

PEPTA would require state and local government plan sponsors to provide specific funding information to the US Treasury Department, including a "Supplementary Report" that would restate the funding status of a plan by valuing assets at fair market value and by using certain Treasury obligation yield curves in place of the plan's expected rate of return to determine liabilities. Failure to do so would cause the offending state or political subdivision to lose Federal tax benefits with respect to any State or local bond issues. NCTR strongly opposes PEPTA.

PEPTA saw little action in 2012. No new cosponsors were added to HR 567, which has 51 cosponsors, all from 2012 and all but one of them Republicans. Nor were any new cosponsors added to S 347, which has 8, all of them Republicans from 2011. Also, unlike 2011, when there were five hearings in the House of Representatives before three different Committees that discussed PEPTA, there were no Congressional hearings in 2012 with PEPTA as a subject.

However, PEPTA did not drop off the radar screen in 2012. Instead, the very kind of scenario that NCTR had most feared presented an opportunity for PEPTA to be included in a piece of "must-do" legislation, from which, once imbedded, it would have been very difficult to strip out.

Specifically, during last-minute deliberations on a top-priority package of legislation, including reauthorization of the Federal Highway Trust Fund as well as a fix to the interest rate subsidy for Stafford student loans – both set to expire after June 30, 2012 -- a handful of pension-related revenue raisers had been targeted for inclusion in the omnibus bill. These included an increase in PBGC premiums, a phased retirement provision for Federal employees, and the stabilization of the interest rate that corporations must use to discount their pension liabilities, recognizing current historically low rates and permitting instead the use of 25-year averages.

While not a part of the original discussions, during last-minute negotiations, House Ways and Means Committee Chairman Dave Camp (R-MI) proposed the inclusion of PEPTA. Even though PEPTA would not raise revenues, it was reportedly in play because there was discussion about imposing additional reporting requirements for private

sector plans in return for their interest rate fix, and someone suggested that if increased reporting was good for the private sector, it would also be good for public plans. Some observers also suggested that it was a bone that Camp was tossing to his Tea Party Caucus members to keep them happy over the increased spending associated with the Stafford loan adjustments.

Key offices involved with conferencing the bill were contacted by their state and local officials, plans, employees and organizations in opposition. Senate opponents of PEPTA also weighed in, and the measure was ultimately not included. However, the same kind of bartering to keep all of the various constituency groups happy could present itself once again in the context of some "fix" related to the fiscal cliff that the current Lame Duck session of Congress is wrestling with. So the threat of PEPTA is not quite yet over in 2012.

Congressional Reports on Public Pension Issues: While governmental plans were not the subject of numerous Congressional hearings in 2012 as they were in 2011, they were the focus of a number of Congressional reports, studies, and "commentaries."

These began with a report issued by Senator Orrin Hatch (R-UT), the Ranking Republican on the Senate Finance Committee, on January 10, 2012, entitled "State and Local Government Defined Benefit Pension Plans: The Pension Debt Crisis that Threatens America." Although this report was not a Finance Committee report, it was nevertheless treated as such by many in the media.

Senator Hatch acknowledges in his report that many states have been involved in an "unprecedented level of state legislative activity" in recent years to address their pension challenges, but claims that the potential effect of state and municipal pension debt on state insolvency or default is nevertheless still significant, and "such an event is a possible contagion that could infect even responsible jurisdictions." He also believes that unfunded pension liabilities of state and local governments have affected the Federal government's credit rating, and municipal insolvency or default threatens to place significant additional burdens on the Federal government's social assistance programs.

Senator Hatch's solution is to do away with defined benefit plans in the public sector. He states that "it is becoming increasingly apparent that defined benefit pension plans will never be financially sound enough over the long term for use by state and local governments." Furthermore, he claims that the financial risks associated with the DB structure are "inherently flawed in the state and local government setting" and that such risks "are uniquely inappropriate for state and local governments."

Senator Hatch said in a press statement accompanying his report that he planned on presenting specific ideas on public pension reform, but no proposal for the reform of governmental pension plans was presented by the Senator in 2012. Indeed, some observers believe that Senator Hatch's report was more about the politics of surviving a primary challenge mounted by State Senator Dan Liljenquist, who had spearheaded pension reform in Utah in 2010, than it was about actually championing Federal public pension legislation. Liljenquist, who resigned from the Utah Senate to run against Senator Hatch, was able to force Senator Hatch into his first primary since 1976.

The Republican staff of the Joint Economic Committee (JEC) continued their series of staff "commentaries" on public pension issues in 2012, also focusing on the risks to the Federal government posed by underfunded public pensions and the potential of state insolvency as a consequence. These JEC minority staff papers actually began in December of 2011, with the issuance of their commentary entitled "States of Bankruptcy Part I: The Coming State Pensions Crisis." This relied almost exclusively on work by Professors Joshua Rauh, at the time from Northwestern University but currently at the Hoover Institution at Stanford University, and Robert Novy-Marx from the University of Rochester. NCTR and NASRA have strongly questioned the accuracy of these academic works on which the JEC minority staff depends.

This first JEC minority staff commentary claimed that a number of plans are projected to run out of money in just over five years based on private sector accounting standards and that the combination of massive unfunded pension liabilities and poor economic policies "are setting many states up for a Greek-style fiscal death spiral." It concluded by stating that "the state pension crisis is virtually unavoidable" but that the Federal government's role in "bearing the burden of irresponsible states" can be mitigated through "preemptive actions that will help prevent a taxpayer bailout of state pension systems."

As promised, the JEC Republican staff followed up with two new commentaries in 2012. The first, "States of Bankruptcy Part II: Eurozone, USA?" was released on May 15, 2012. In it, the JEC Republican staff argued that if current trends continue, the United States may be heading toward a "two-tiered, European-style economic system, where taxpayers in prudent, prosperous states are forced by Washington to subsidize the imprudent and improvident governments of neighboring states." State pension funds "may well be the catalyst that ultimately triggers the Eurozone-style splitting of the American economy between contributory and dependent member states," according to this staff commentary.

The GOP staff discusses a number of what it views as indicators of the coming crisis, such as tax rates, debt, and Right-to-Work laws versus what it calls "forced unionism." However, time and again the discussion of "good" states versus "bad" states focuses on their pension plans. "Without significant and immediate reforms," according to the Republican staff, "the combination of a constitutional guarantee for most state pension benefits and the inability of states to declare bankruptcy sets the stage for a massive federal bailout."

The second release from the JEC minority staff in 2012, "The Pending State Pensions Crisis," was issued on September 26th. Building on the two previous commentaries, it concludes that "Pension protections and the magnitude of pension liabilities make [Federal] bailout requests inevitable." The size of the coming crisis is so large, they argue, that reasonable tax increases and spending cuts will not solve the problem. "And if public employee unions continue to refuse any sort of reform that would bring public sector pensions more in line with private sector retirement systems, the states will inevitably come knocking on the federal government's door for a bailout," the GOP staff warns.

What will happen? Whether it is "sympathy, cronyism, fears of financial contagion, or a desire to further increase the size and scope of the federal government," the Republican staff concludes that "Washington policymakers will no doubt find it difficult to say no to saving the pensions of retired teachers and firefighters after a past Congress bailed out the big U.S. banks and automakers."

Furthermore, this commentary also warns that simply passing legislation stating there will be no Federal bailout of state pensions "is not enough." Instead, in order to preemptively deter states from seeking bailouts, the JEC Republicans argue that Congress "could conditionally reduce federal aid to states in proportion to their unfunded liabilities until their pension fund becomes solvent over a specified future time frame" or states' tax free bond status could be revoked if private-sector accounting standards show that their pension funds are expected to go broke within 10 years or less.

In short, the JEC minority staff is calling for an enforceable Federal yardstick with which to measure the adequacy of state pension reforms. This could become the focus of opponents of public sector DB plans in 2013.

However, not all Congressional reports in 2012 focused on public pensions and their problems. In an effort to shine the spotlight on the need to find a solution to the retirement security problems of all Americans, Senator Tom Harkin (D-IA), the Chairman of the Senate Health, Education, Labor and Pensions (HELP) Committee, issued a report in July documenting a national retirement crisis and proposing a new national debate on how to solve it.

Harkin says he intends for his report to be "the starting place in an evolving discussion about retirement security." His report, "The Retirement Crisis and a Plan to Solve It," was released on July 27, 2012, and begins by documenting the nature and degree of the problem. Senator Harkin warns that as older Americans transition out of the

workforce, either voluntarily or involuntarily, "many will find that they cannot afford basic living expenses" and that they "will be forced to make the difficult choice between putting food on the table and buying their medication."

Senator Harkin believes that there is a clear picture of the kinds of changes needed to ensure the American retirement system can work for everyone. These changes can be reduced to what he terms as four basic principles:

1. The retirement system should be universal and automatic.
2. The retirement system should give people certainty that they will have a predictable stream of retirement income that they cannot outlive.
3. Retirement is a shared responsibility among individuals, employers, and the government; it is unfair for any one player to shoulder the burden alone.
4. Retirement assets should be pooled and professionally managed.

Meredith Williams immediately sent a letter to Senator Harkin offering support and telling the Senator that NCTR stands ready to work with him to find a solution to the retirement security needs of all Americans. Harkin said that over the coming months, he plans to bring together business and labor leaders, policy experts, advocates, and his fellow lawmakers to implement necessary reforms. "Please count us in," Williams told the Senator.

When announcing his report, Senator Harkin was quoted as saying that "I am under no illusions that we're going to get anything done this year, but I want to be ready to go in with this next year." Indeed, no bill was introduced in 2012, but Senator Harkin's staff advises that he fully intends to make this a top priority in 2013.

GPO/WEP Repeal: HR 1332, the Social Security Fairness Act, which would repeal the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP), was introduced in the House of Representatives on April 1, 2011, by Congressmen Howard Berman (D-CA) and Howard "Buck" McKeon (R-CA). The Senate version of the legislation, S 2010, was introduced on December 16, 2011, by Senators John Kerry (D-MA) and Susan Collins (R-ME).

The GPO applies only when the Social Security (SS) benefits are received by a spouse or widow(er); generally, under this provision, any SS benefit may be reduced by two-thirds of the amount of a government pension that the spouse or widow(er) is also receiving. The WEP affects how a SS retirement or disability benefit is determined for persons eligible for their own (not spousal) SS benefits when they also receive a pension from work not covered by Social Security. The formula used to figure the SS benefit amount is modified, and essentially provides for a smaller benefit.

HR 1332 has 170 cosponsors, of which 36 were added in 2012. The last cosponsor signed onto the bill in June of 2012. The bill was referred to the House Ways and Means Committee, which has held no hearings on the legislation in the 112th Congress.

S. 2010 has 18 cosponsors, 17 of whom signed on in 2012. The last Senator cosponsored in July of 2012. The bill was referred to the Senate Finance Committee, where no hearings have been held during the 112th Congress.

GPO and WEP have been the subject of repeal efforts for the last several decades. However, support for a total repeal seems to be waning. For example, similar repeal legislation in the previous Congress (2009-2010), had 334 cosponsors in the House (HR 235) and 31 in the Senate (S 484). The primary problem continues to be the cost of repeal. Based on recent estimates (2010), the total for both would be about $90 billion combined.

An alternative approach to outright repeal would be to reform the formulas, and legislation to do so was also introduced in the 112th Congress. For example, Congressman Kevin Brady (R-TX) introduced HR 2797, the Public Servant Retirement Protection Act (PSRPA), on August 5, 2011. The bill would repeal the current WEP and establish a new formula which would be applied to individuals subject to the current WEP if the benefit under the new formula would be higher. However, the bill has just 8 cosponsors, only one of whom signed on in 2012. The Senate

companion bill, S. 113, introduced by Senator Kay Bailey Hutchison (R-TX) on January 25, 2011, and cosponsored by Senator Patrick Leahy (D-VT), has picked up no other cosponsors.

The potential linkage of GPO/WEP repeal to mandatory Social Security as a means of paying for its cost continues to be a concern, and is one reason why, once again, repeal legislation in this area garners support but continues to go nowhere, as was the case in 2012. Absent major reform of Social Security, this is likely to remain to be the case, although the potential changes to entitlement programs as part of the overall response of Congress and the Obama Administration to the nation's economic problems could open up possibilities for reform in this area in 2013.

Mandatory Social Security: Social Security covers about 94% of all workers in the United States, but about one-fourth of state and local government employees are not covered by Social Security. When Social Security reform efforts are seriously in play, they often include proposals to place newly-hired public employees in Social Security. However, there were no major reform proposals that received serious attention from the Congress in 2012, and so mandatory Social Security was also pretty much off the table as well.

In the past, mandatory Social Security coverage of newly hired state and local government workers was proposed in part to address Social Security funding needs. For example, it has been projected that doing so would close an estimated 8% to 9% of Social Security's projected average 75-year funding shortfall and extend Social Security trust fund solvency by 2 to 3 years.

However, when seriously considered in the past, the proposal has always eventually been abandoned as too disruptive and expensive, projected to cost states, localities and public workers an estimated $53.5 billion in the first five years alone, based on a report for the Committee to Preserve Retirement Security (CPRS) prepared by The Segal Company in September of 2011. Indeed, it has always been assumed that mandatory Social Security would not be considered separate and apart from an overall discussion of needed changes to Social Security as a whole.

Now, however, this linkage appears to no longer be a given. In 2010, both the President's Deficit Commission (aka the Simpson-Bowles commission) and the Domenici-Rivlin Budget Task Force proposed that all newly-hired employees of state and local governments after 2020 be covered under Social Security. Furthermore, the reasons for this had more to do with perceived threats to the retirement security of public employees and the desire to avoid a federal bailout of public pension plans than it did with the solvency of Social Security.

For example, the Simpson-Bowles report argued that "Full coverage will simplify retirement planning and benefit coordination for workers who spend part of their career working in state and local governments," and will "ensure that all workers, regardless of employer, will retire with a secure and predictable benefit check."

The Domenici-Rivlin Task Force took a somewhat similar tack, explaining that including these new government employees in Social Security would "provide better disability and survivor insurance protection for many workers who move between government employment and other jobs." Furthermore, according to the Task Force, "Over the long run, covering all of their employees under Social Security could help states and localities get their fiscal houses in order through transitioning to more sustainable pension programs."

Most recently, concerns have been raised with the possibility that mandatory Social Security, having been de-linked from overall Social Security reform, could present an attractive source of revenue as Congress struggles to address the fiscal cliff crisis and perhaps come up with a new "down payment on the deficit" in order to garner GOP support for an increase in the Federal debt limit.

For example, the Congressional Budget Office has estimated that mandatory Social Security for newly-hired public employees could increase net Federal revenues by $24 billion over 5 years and $96 billion over 10 years. These are very attractive sums when lawmakers are struggling to put a package deal together. Furthermore, if mandatory Social Security for all new public employees can be justified as a means of helping states and localities get their

fiscal houses in order, providing them with more sustainable pension programs and helping to make a possible Federal bail-out of public pensions less likely, then such a temptation might be irresistible.

Finally, while there are currently no vocal supporters of mandatory Social Security coverage for state and local government new hires pushing for such on Capitol Hill, the discussion of the need for entitlement reforms as part of deficit reduction may be creating a possible environment in which Social Security reform could finally be in the making in 2013.

JCT Report Estimates Cost of Retirement Savings Tax Incentives: On February 1, 2013, the Congressional Joint Committee on Taxation (JCT) released its annual analysis of Federal tax expenditures for the five year windows of 2012-16 and 2013-17, showing that retirement savings incentives were number two on the list of the most costly for the Federal government.

This is a very important report. It will certainly be much-used in any tax reform debate in which Congress engages this year, as it calculates the amount of revenue "losses" (the term the Budget Act uses) that the Federal government will incur due to certain provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income, or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.

Among the top three most expensive classes of tax expenditures is that related to retirement security. The new JCT report estimates that for the period 2012-16, the tax expenditures associated with defined benefit plans will amount to $198.9 billion, and those associated with defined contribution plans will total $306.4 billion. For the period 2013-17, the amounts increase to $212.2 billion for DB plans and $335.6 billion for DC plans.

When all other types of retirement savings incentives are included, such as Keogh plans and IRA's, the Federal revenue losses associated with the net exclusion from taxation of pension contributions and earnings are estimated to total $654.3 billion for 2012-16, and $714 billion for 2013-17. (See pages 39-40 of the JCT report.)

This is more than the $364 billion in losses due to the home mortgage interest deduction for 2012-16, (estimated to increase to $379 billion for the 2013-17 window). The only tax expenditure that produces more revenue losses for the Federal government than retirement security is employer-provided health care, with $706.6 billion in losses associated with the exclusion of employer contributions for health care, health insurance premiums, and long term care insurance premiums for 2012-16 (estimated to rise to $760.4 billion for the 2013-17 window.)

To summarize:	**2012-16**	**2013-17**
Employer-provided health care "cost"	$706.6 billion	$760.4 billion
Retirement security incentives "cost"	$654.3 billion	$714 billion
Home mortgage interest deduction "cost"	$364 billion	$379 billion

Bipartisan Tax Reform Working Group on Pensions/Retirement Created: House Ways and Means Committee Chairman Dave Camp (R-MI) and the Ranking Democratic on the Committee, Sander Levin (D-MI), have *announced* the formation of bipartisan tax reform working groups, the purpose of which will be fact finding and information gathering about present tax law. There will be 11 subject area groups, including one for "Pensions/ Retirement." One Republican Member and one Democratic Member will be named to lead each group, but all of the groups will be open to all of the Committee Members. For the Pensions/Retirement Group, the Republican leader will be Pat Tiberi (R-OH) and the Democratic leader will be Congressman Ron Kind (D-WI).

Congressman Tiberi is the Chairman of the important Subcommittee on Select Revenue Measures, which handles pension issues. It was significant that when the House Ways and Means Committee held its only hearing on the Public Employee Pension Transparency Act (PEPTA) in July of 2011, it was not before Congressman Tiberi's Subcommittee, which technically had legislative jurisdiction over the measure, but instead before the Oversight Subcommittee. Some took this to suggest Congressman Tiberi might not be very supportive of the PEPTA legislation.

Congressman Kind has been very receptive to public pension issues, and introduced legislation in the last Congress that would have provided a resolution of governmental plans' problems with Normal Retirement Age regulations. Also, at the Ways and Means hearing on PEPTA, noted above, Mr. Kind opposed the legislation.

According to Congressman Levin, the Members will be given a fair amount of leeway to determine the process of soliciting stakeholder input for their group. In a conversation with Levin's pension staffer, NCTR was assured that public pension organizations would be given an opportunity to have input once the Pensions/Retirement Group's plans were formalized. The groups will work in conjunction with the staff of the Joint Committee on Taxation, but are not expected to make policy recommendations or produce draft legislation. Instead, each group is expected to provide a report to the full Committee, due on April 15th.

The creation of the groups is taken as another sign that Chairman Camp is strongly committed to tax reform, which he has called one of his top priorities.

On the Senate side, Finance Committee Chairman Max Baucus (D-MT) reportedly hopes to release some kind of discussion draft or an options paper on tax reform sometime this spring.

TREASURY/IRS

Normal Retirement Age Regulations: After five years in which the nature of the application of the so-called Normal Retirement Age regulations to public plans remained in virtual limbo, in 2012 the Internal Revenue Service (IRS) finally provided an indication that revised guidance was in the works that would address governmental plan concerns with the original regulations. Furthermore, the IRS once again extended the effective date – this time until January 1, 2015, at the earliest. Before the issuance of Notice 2012-29 on April 30, 2012, the regulations as drafted in 2007 were set to take effect for governmental plan years beginning on or after January 1, 2013.

The original IRS regulations in 2007 reflected a change made by the Pension Protection Act (PPA) of 2006 that provided an exception to the general plan qualification rule that pension benefits can be paid only after retirement. This PPA exception permitted a pension plan to commence payment of retirement benefits to an employee who is not separated from employment at the time of such distribution (known as an "in-service distribution") as long as the employee has attained age 62.

However, the IRS also used this opportunity back in 2007 to (1) "clarify" that a pension plan is also permitted to make such in-service distributions after the participant has attained "normal retirement age;" and (2) provide rules on how low a plan's normal retirement age is permitted to be.

Significantly, the 2007 regulations did not provide guidance with respect to a normal retirement age that is conditioned (directly or indirectly) on the completion of a stated number of years of service, as is the case with many if not most public plans. Furthermore, in a notice (IRS Notice 2007-69) issued in August of 2007, the IRS and Treasury specifically asked governmental plans to submit comments on whether a normal retirement age under such a governmental plan may be based on years of service. The inference was that such normal retirement "ages" might not be permissible.

If this were indeed to be the case, there would be major problems ahead for governmental plans. NCTR and NASRA filed comments strongly objecting to this approach and have held a number of meetings with the IRS and Treasury over the last five years to explain the major concerns that would arise and to seek relief.

The 2012 Notice appears to provide for such. First, it indicates that the regulations will be modified for governmental plans such that if the plan does not provide for the payment of in-service distributions before age 62, then it will not be required to have a definition of normal retirement age at all. Furthermore, if such a plan does have a definition of what constitutes a normal retirement age, the definition does not need to meet the requirements of the 2007 regulations. This would appear to do away with any concerns as to normal retirement ages being based in whole or in part on years of service for plans that do not provide in-service distributions before age 62.

While this seems to represent a major victory for governmental plans, there are nevertheless a number of missing details in which the devil may still be lurking. For example, how, exactly, does the IRS define an in-service distribution? What about return-to-work programs in the public sector? Could these programs be seen by the IRS as in-service distributions in certain instances? Also, what about part-time work? And if a plan does provide in-service distributions before age 62, can it still have a normal retirement age based on service? There are a number of these and other concerns that are left unanswered.

NCTR, NASRA, and 11 other national organizations addressed a number of these in formal comments filed with the IRS on June 15, 2012. In this comment letter, three major points were made:

1. "First and foremost," the IRS and Treasury were asked to issue proposed regulations before finalizing the application of any normal retirement age rules on governmental plans. "Even with the modifications outlined in Notice 2012-29, current definitions remain unclear with regard to their application to state and local retirement plans across the country," the letter stressed, "and we believe further changes and comments are needed."
2. With regard to governmental plans, the 2007 regulations should solely pertain to the conditions that must be met to permit an in-service distribution before age 62. In-service distributions prior to age 62 should not cause the 2007 regulations to apply to the governmental plan's other provisions such as eligibility for unreduced benefits, etc.
3. Finally, the time at which a participant in a governmental plan qualifies for an unreduced benefit is the earliest typical age when participants (in a particular benefit structure and employee classification) retire and this should therefore be treated by the IRS and Treasury as an acceptable normal retirement age for the purposes of the 2007 regulations. The letter points out that this clarification would recognize that governmental plans often contain multiple benefit structures and cover multiple employee groups, each which may have a separate normal retirement age under the plan, and that governmental pension plans typically have normal retirement ages that include a service component or are exclusively service-based.

In conversations with Treasury and the IRS following the issuance of Notice 2012-29, it does appear that they intend to issue their proposed modifications in the form of a proposed regulation which would be open to additional public comment. However, nothing is certain at this point. Nevertheless, for 2013 at least, the threat of the application of onerous Normal Retirement Age regulations to governmental plans has been delayed, and hopefully more information on the issues and concerns that NCTR and others have raised will be forthcoming in the new year.

Definition of a Governmental Plan: Following reportedly more than 10 years of review and discussion with other Federal agencies, the Internal Revenue Service and the Treasury Department published their long-awaited Advance Notice of Proposed Rulemaking (ANPRM) relating to the definition of the term "governmental plan" under section 414(d) of the Internal Revenue Code (IRC) on November 8, 2011. The notice also contained an appendix setting

forth a draft of possible proposed regulations. (These regulations have not actually been proposed yet, and are provided as an example of what a proposal in this area might look like.)

If a public plan fails to meet this definition, then ERISA titles I (Federal protection of employee benefit rights, administered by the DOL's Employee Benefits Security Administration) and IV (plan termination insurance, enforced by the PBGC) would technically apply to it. In addition, the nondiscrimination and minimum participation rules of the Federal tax code would also apply, as would the minimum funding standards. Therefore, the ultimate outcome of this process will have major implications for governmental plans, their sponsors, and participating employers and employees.

Briefly, the draft of proposed regulations attached to the ANPRM would provide guidance on determining whether an entity is an "agency or instrumentality of a State or a political subdivision of a State" based on a facts and circumstances test. Major factors for determining whether an entity is an agency or instrumentality of a State or political subdivision of a State include whether:

- The entity's governing board or body is controlled by a State or political subdivision;
- The members of the governing board or body are publicly nominated and elected;
- The entity's employees are treated in the same manner as employees of the State (or political subdivision thereof) for purposes other than providing employee benefits (for example, the entity's employees are granted civil service protection);
- A State (or political subdivision thereof) has fiscal responsibility for the general debts and other liabilities of the entity (including funding responsibility for the employee benefits under the entity's plans); and
- In the case of an entity that is not a political subdivision, the entity is delegated, pursuant to a statute of a State or political subdivision, the authority to exercise sovereign powers of the State or political subdivision (such as, the power of taxation, the power of eminent domain, and the police power).

Other factors would include whether:

- The entity's operations are controlled by a State (or political subdivision thereof);
- The entity is directly funded through tax revenues or other public sources;
- The entity is created by a State government or political subdivision of a State pursuant to a specific enabling statute that prescribes the purposes, powers, and manners in which the entity is to be established and operated.;
- The entity is treated as a governmental entity for Federal employment tax or income tax purposes (such as, the authority to issue tax-exempt bonds under section 103(a)) or under other Federal laws;
- The entity is determined to be an agency or instrumentality of a State (or political subdivision thereof) for purposes of State laws;
- The entity is determined to be an agency or instrumentality of a State (or political subdivision thereof) by a State or Federal court;
- A State (or political subdivision thereof) has the ownership interest in the entity and no private interests are involved; and
- The entity serves a governmental purpose.

Unfortunately, the IRS has so far refused to provide any weighting of these factors. For example, at the Cleveland town hall meeting, IRS officials advised that an entity could meet all of the factors and still not be considered a governmental entity, and conversely, could fail to meet all of them and still be approved.

With regard to the determination as to whether a governmental entity has established and maintained a governmental plan for purposes of section 414(d), the draft proposed regulations would provide that a plan is established and maintained for the employees of a governmental entity if the employer that has established and maintained the plan is a governmental entity and the only participants covered by the plan are employees of the governmental entity. With the exception of union employees/representatives in the case of a collectively bargained plan, and employees of the plan itself, the draft proposed regulations do not include a de minimis rule addressing existing practices under which a small number of non-governmental employees may participate in a governmental plan without threatening its status as such. However, the IRS is specifically seeking comments on whether such a rule should be included.

In 2012, the IRS began a very methodical approach to this ANPRM, which is just the first step in what will be a multi-year process. Throughout 2012, the IRS held "town hall" meetings across the country on their proposal. These meetings occurred on March 15, 2012, in Oakland, CA, and in Cleveland, OH, on May 3, 2012.

A joint survey of NASRA/NCTR members concerning the ANPRM was also conducted in 2012 in order to provide the IRS with more information. This survey found that a very large majority of plans responding (84.5%) have employers other than their state participating in their plans, and that of these plans, 69.4% have participating employers that are other than conventional units of local governments (such as counties, cities, towns and villages) or school districts/corporations or wholly public universities/colleges.

On a going forward basis, 60 percent of the survey respondents said that they would prefer to see "fairly strict" rules limiting the inclusion of quasi-public entities and/or non-governmental entities in governmental plans. With regard to transition rules (as to current employers whose participation might be affected if the rules ultimately adopted by the IRS would have barred their participation), 55.4 percent favored allowing participating employers who are currently in a plan to remain in with no restrictions on future employees of the employer becoming/being members, while 41.1 percent voted to allow participating employers who are currently in the plan to remain in, but only as to their current employees.

NCTR, NASRA, the Government Finance Officers Association (GFOA), the National Association of Government Defined Contribution Administrators (NAGDCA), and the National Conference on Public Employee Retirement Systems (NCPERS) filed joint comments on the ANPRM on June 15, 2012. These comments focused on safe harbors, grandfathering, and transition/administrative challenges.

With regard to safe harbors, the letter proposed that if an entity satisfied any one of the following tests, then the entity could establish and maintain a governmental plan for its employees and/or could participate in a multiple employer governmental plan without consideration of any other factors:

- Fiscal responsibility – has fiscal responsibility for the general debts and other liabilities of the entity, including employee benefit plans.
- Elected Board -- majority either controlled by State/political subdivision or elected through periodic, publicly held elections;
- Sovereign Powers – taxation, police, eminent domain, others as defined by the state constitution;
- Federal Tax – had a 218 agreement; authority to issue tax-exempt bonds; a 115 ruling (determination of status);
- Federal Law -- treated as agency/instrumentality pursuant to a Federal law (other than IRC) or by other Federal agency;
- Court Ruling – had a state or Federal court ruling as to status as a governmental entity.

The comment letter also proposed that grandfathering could apply to both current and future employees of the entity, but should be permissive based upon the plan provisions, if the entity, as of the effective date of the final regulations:

- has a favorable private letter ruling;
- is participating pursuant to specific terms of state or local law;
- is in a multiple employer plan and is participating pursuant to a procedure provided for in the plan document (i.e. where plan document allows nonprofit instrumentalities to participate in a plan subject to approval by plan's governing body).

The letter also asks that flexibility be allowed under the regulations so that, if the status of an employer changes from a governmental entity to a private entity, the employees covered by the plan prior to the conversion could be, but would not be required to be, allowed to remain in the governmental plan. Also, it was suggested that the regulations should make it clear that, if a multiple employer governmental plan has reasonable procedures in place to determine whether a participating employer is a governmental agency on instrumentality, the multiple employer governmental plan's status will not be adversely affected if there is a subsequent determination that a particular employer is not a governmental entity.

A similar approach should be taken with respect to the determination of employee status, the letter urges, so that a multiple employer governmental plan that reasonably relies on the participating employer's representation as to the eligibility of participating employees should not have the plan's governmental status jeopardized if the employer has mis-reported an individual's employment status.

With regard to a de minimis rule, the letter states that prospective de minimis standards would not be necessary if the IRS and Treasury agree with the letter's suggestions on grandfathering and transition. "However, if the final rules do not provide other relief that protects plans' governmental status, a de minimis standard should be included in the final rules," the letter concludes.

Finally, the comment letter urges that the IRS establish an expedited ruling process to determine governmental entity status, with a reduced fee.

The IRS also held a formal public hearing in Washington, DC, on July 9, 2012, at which NCTR, represented by Meredith Williams, NCTR's Executive Director, as well as NASRA, represented by Cindy Rougeou, Executive Director of the Louisiana State Employees' Retirement System, provided testimony.

To date, the reaction to the ANPRM by some potentially affected groups has been very vocal. This is particularly true with regard to community/ charter school employees, even though the draft proposed regulations do not explicitly exclude charter schools' employees from participation in governmental plans. These employees nevertheless fear that they would be excluded from participating in public plans, and that public plans that included such employees would be disqualified.

Charter school employees contacted the IRS by the thousands in 2012. In addition, the National Alliance for Public Charter Schools has issued a position statement which concludes that charter schools are public schools and that "the degree of state control over charter schools and public funding of such schools justify amending the Proposed Regulation such that public charter schools are considered agencies or instrumentalities of the state for purposes of the Internal Revenue Service's 'governmental plan' definition."

Many think that the IRS may have bitten off more than it can chew with this ANPRM, and that the process, already guaranteed to be a slow and deliberate one by the nature of its structure, could take even longer than originally expected. The IRS is currently in the process of reviewing the 2,300 comments that have been received, and it may well be that no further steps are taken on this project in 2013.

Treatment of "Picked-Up" Contributions: Revenue Ruling 2006-43 provides, in part, that a participating employee whose contributions are being "picked up" by the employer through an IRC Section 414(h)(2) employer pick-up – which is how employees' contributions to their public sector DB plans are able to be made in before-tax dollars –

cannot, from and after the date of the "pick-up", have a cash or deferred election right with respect to such designated employee contributions.

Accordingly, participating employees must not be permitted to opt out of the "pick-up", or to receive the contributed amounts directly instead of having them paid by the employing unit to the plan. However, a number of jurisdictions who are experimenting with new elective tiers that have been designed as elements of pension reform and that can change the level of the "picked-up" amount are concerned that these could be viewed by the IRS as a prohibited cash or deferred arrangement (CODA) under the plan. These jurisdictions include Orange County, California, and most recently the city of San Jose.

Whether through private letter ruling requests filed with the IRS, meetings with Treasury staff, discussions on the Hill, or outreach to other public employers who are looking at ways to control or shift pension costs, activity surrounding this problem has increase in 2012.

NCTR and NASRA are concerned that this activity could result in an interpretation of Revenue Ruling 2006-43 that not only prohibits any employee from opting out of the pick-up, but also bars any election that changes the amount of the employee's picked-up contribution (as it too would allow the employee to elect more current or deferred compensation). This could affect such things as opting into a new benefit tier that has a different employee contribution rate, electing to purchase service credit through salary reduction, or entering a deferred retirement option plan whereby the employee contributions to the plan are terminated.

Such an interpretation would also run counter to previous favorable IRS rulings that specifically allowed the use of pickups where individual employees make an irrevocable election to have contributions made to a plan on their behalf by payroll deduction, as well as legislative history where Congress has stated its intent not to interfere with pickups to purchase service credits. Also, under the Pension Protection Act of 2006, Congress specifically reaffirmed the ability of public employees to purchase service under a plan whereby "a lower level benefit is converted to a higher benefit level otherwise offered under the same plan."

NCTR and NASRA therefore initiated discussions with Treasury in 2011 to address the potential unintended impact of the current reading of the Revenue Ruling – and any further moves to interpret its application in other settings. Specifically, concerns have been expressed that any action by Treasury that officially affirms this reading of RR 2006-43, even in part, could raise issues for many plans. Furthermore, a proscriptive outline by Treasury of the timing, circumstances, financial condition, etc. under which a new tier or plan can receive picked up contributions (which was referenced in meetings as a potential amendment to the existing ruling) could easily send the wrong message as to a single one-size-fits-all Federal solution in this area where flexibility is needed, not increased Federal restrictions on state and local pension decisions.

Complicating matters is a concern on the part of some public sector unions that Treasury should not approve an interpretation that permits employees, on an individual (vs. collective) basis, to elect into different tiers with different mandatory contribution amounts, suggesting that all individually elected contributions should be excluded from pick-up eligibility unless they are to increase contributions or move to a higher benefit under the plan.

In addition to private letter ruling requests, which continue to be held up as the IRS and Treasury continue to work on a resolution to the problem, legislation (HR 2934) was introduced in the House of Representatives by Congresswoman Loretta Sanchez (D-CA) on September 14, 2011. Her bill would clarify the treatment of certain retirement plan contributions picked up by governmental employers to permit the treatment of certain employer contributions made to public retirement plans as picked up by an employing unit regardless of whether the participating employee is allowed to make an irrevocable election between the application of two alternative benefit formulas involving the same or different levels of employee contributions. The bill has only three cosponsors and received no consideration in 2012.

Most recently, the mayor of San Jose, California, Chuck Reed, has taken up the cause based on a ballot measure that passed in June of 2012 in San Jose to modify pensions for current city employees. San Jose has filed a private letter ruling request concerning this matter with the IRS, and the Mayor has been meeting with other state and local officials, including governors and other mayors, seeking support for a resolution to this problem, as well as with members of Congress and officials at the Treasury Department.

He has also been instrumental in obtaining approval by the National League of Cities as well as the U.S. Conference of Mayors, of similar resolutions supporting his efforts.

- NCTR and NASRA are working closely with Mayor Reed and others to see that a resolution to this issue is obtained that will ensure needed flexibility for state and local governments in the development of their pension policies without creating unintended consequences for important tools currently used by many plans involving the employer pick-up. In 2013, NCTR will once again meet with Treasury to discuss policy considerations in this area in an attempt to obtain a clarification of Revenue Ruling 2006-43.

SECURITIES AND EXCHANGE COMMISSION

Rule to Treat Certain Public Pension Trustees as Municipal Advisors: Since the end of 2010, the Securities and Exchange Commission (SEC) has been considering a rule that would clarify what constitutes a "municipal advisor;" provide a permanent registration process for them; and impose an express Federal fiduciary duty on municipal advisors in their dealings with governmental entities. In 2012, Congress stepped in and began to move legislation to address certain of the proposed rule's issues, including its application to certain public pension trustees.

In crafting the rule and who would be exempt from it, the SEC determined that even though the financial reform legislation passed earlier that year and often referred to as Dodd-Frank had excluded employees of a "municipal entity" – which term is defined to include public pension funds, local government investment pools and other state and local governmental entities or funds, along with participant-directed investment programs or plans such as 529, 403(b), and 457 plans -- from the definition of "municipal advisor," the statute did not explicitly refer to members of a board or other governing body of a municipal entity who might not technically be employees.

Therefore, the SEC rationalized that elected and ex officio board members are "accountable" for their performance to the citizens of the municipal entity, as opposed to appointed members, who, in the SEC's view, are not. Accordingly, the SEC proposed that the former would be included in the exemption, while the latter would not. Thus, if the rule were to be adopted in final form as the SEC has proposed, some public pension trustees might have to register with the SEC, pay the registration fee, and comply with the Federal fiduciary standard, while their ex officio colleagues would not.

NCTR and NASRA filed joint comments with the SEC on February 22, 2011, objecting to this approach. Among several other points, the letter argued that all trustees of state and local government retirement systems (whether elected or appointed), as members of a governing body of a governmental pension fund, are, per se, a part of that municipal entity, and, as such, are therefore expressly excluded from the definition of a "municipal advisor."

The letter also pointed out that public pension trustees are already held to strict accountability standards, whether elected or appointed. Furthermore, the letter cautioned that creating "burdensome and costly registration requirements would also serve to discourage service on public pension boards, which could diminish rather than enhance the quality of these governing bodies."

The SEC has received over 1,200 comments on its proposed rule, but has yet to issue a final version. In addition, the SEC has been the target of increasing Congressional pressure, particularly from the House, and in testimony before Congress, former SEC Chair Mary Shapiro conceded that the agency "may have cast the net too widely."

As the September 30, 2012, SEC deadline for action on the rule drew near, the House Financial Services Committee, in a 60-to-0 vote, unanimously approved legislation, HR 2827 introduced by Congressman Robert Dold (R-IL), on September 12, 2012. Congressman Barney Frank (D-MA), the ranking Democrat on the Committee, voted for the bill, indicating that the SEC had advised him that it had no objection to the legislation.

The bill would, among other things, exempt certain activities of nine different categories of professionals, including "any elected or appointed member of a governing body of a municipal entity or obligated person, with respect to such member's role on the governing body." Shortly thereafter, on September 19th, the full House approved HR 2827 and sent it on to the Senate, where it has been referred to the Senate Banking, Housing and Urban Affairs Committee and has received no further action.

Although it is highly unlikely that any further consideration will occur on this legislation before the close of the 112th Congress, and the SEC has recently given itself an extension of another year to complete action on the rulemaking, the new SEC Chairman, Elisse Walter, was recently quoted in the press as saying that there is no intention on the part of the SEC staff to take anywhere near that long.

Therefore, it is very likely that action will be completed on this rulemaking in 2013, and that, given the SEC's lack of objection to the House-passed bill, an exemption will be made for all public pension trustees from treatment as a municipal advisor, and not just ex officio members.

SOCIAL SECURITY ADMINISTRATION

Changes to the SSA Death Master File: Section 205(r) of the Social Security Act prohibits the Social Security Administration (SSA) from disclosing State death records—received through contracts with the States—which SSA has not independently verified. Accordingly, when SSA realized that it had not been following its own law, it removed all State death records received through the Electronic Death Registration (EDR) system from SSA's Death Master File (DMF) in November of 2011.

Furthermore, SSA decided that it will not include any new State EDR records on the DMF update file available to the public through the Department of Commerce, National Technical Information Service (NTIS). This change reportedly has resulted in 4.2 million records being removed from the Social Security Death Index (SSDI) and as much as a million less records being included in the DMF going forward (a nearly 36 percent decrease) in 2012.

This has raised concerns for retirement plans and others who use this file to ensure payments are not being made beyond the lives of their members. The current law does provide that SSA may disclose all death data, including State EDR records, directly to State or Federal agencies administering federally funded benefits and to States to administer benefit programs wholly funded by the State. However, SSA has determined that because employees help fund the pension plan, it is not "wholly funded" by the state and plan requests to receive all death data have been denied.

A number of public plans have been very actively lobbying on this issue. They advise that it is highly unlikely that SSA will change its position concerning public pension access to the data. According to reports, top SSA legislative staff has emphatically told governmental plan representatives that the SSA will not change on this point unless directed to do so by the Congress.

As for a legislative solution, nothing has been able to be moved in 2012, despite the interest of House Social Security Subcommittee Chairman Sam Johnson (R-TX), who acknowledges the vital role the DMF plays in preventing fraud, waste and abuse, including improper payments sent to those who are deceased. There has also been talk that SSA has developed specifics for legislation dealing with the overall issue of access, but it is not really going anywhere.

The problem is that both House and Senate members are very leery of any legislative solution that does not have buy-in from the governors and from others who are very concerned with identity theft, including the IRS, Treasury, AARP, and a number of union groups. They do not want to sponsor a bill that gives them bad press as a result of some breach in the security of Social Security numbers down the road.

Furthermore, while there is broad support for public and private pension plans as well as insurance companies to have access to the data, there are a significant number of other interest groups who also seek similar access, including many financial interests (banks, credit unions, mortgage companies and groups such as the Consumer Data Industry Association) as well as a number of medical groups including researchers and a number of registries including transplants, many security related groups and genealogists.

One possible legislative fix would be to delete the word "wholly" from the statute, and there have been a number of discussions with individual Congressional offices as well as with committee staff as to the feasibility of such an amendment. However, once again no one seems prepared to step up to the plate. Also, there is concern that such an effort would serve as a lightning rod for the other groups who want access, and this could muddy the waters and spoil any chance of success.

Another alternative is for the States, which control the data, to explore someone other than SSA as the entity to provide the information, such as an outside, non-governmental organization. One such entity being considered is reportedly the National Association of Public Health Statistics and Information Systems (NAPHISIS) to serve as the source of death records if SSA does not continue in this role. Their members are comprised of the state boards of vital statistics and so are in a good position to serve as such, and they are currently working to complete an electronic death data reporting system. But what will the costs of using them be for plans?

If this issue is to get any real traction in 2013, more public plans will need to become active on the issue. More involvement on the part of the National Governors Association will be needed, and updated information from pension systems as to the current status of decline of death data will also be required. Even then, it may well prove to be an uphill battle if 2012 is any indication of the chance for real progress.

San Jose Mayor Chuck Reed's email to other U.S. Mayors (sent through U.S. Conference of Mayors listserv):

Cities across the country are suffering from the impacts of fast rising pension costs that are devouring funds for basic services. Many of those cities will have to increase the amount employees pay for their pensions because other changes are prohibited by state laws. Such increases can be a heavy burden for employees. There is an alternative to cutting services or making employees pay more. Employees can be given an individual option to choose a lower cost set of pension benefits, which will save the city and the employee money.

Making changes to a pension plan may raise questions from employees about tax treatment of contributions. Those questions could be answered by private letter rulings or official guidance from the IRS. Unfortunately, Treasury stopped issuing rulings in 2006 that would facilitate giving employees a choice of lower cost benefits.

Thanks to the support of the U. S. Conference of Mayors, Treasury intends to issue policy guidance on this very topic as part of its *2012-2013 Priority Guidance Plan*, which is used to identify and prioritize the most important tax issues that should be addressed and to help clarify ambiguous areas of the tax law. However, given the large number of other issues also included in that plan and the limited number of Treasury staff available to do the work, it is important for Treasury officials to hear from Mayors that we need action now.

The attached letter urges Treasury to dedicate the staff time necessary to issue the guidance quickly. It can easily be tailored to reflect your particular situation.

I would be happy to speak with you about this effort should you have any questions or need additional information. I can be reached at 408-535-4800. Both the National League of Cities and the U.S. Conference of Mayors have formally adopted policy resolutions in support of this effort.

Thank you for your consideration.

Chuck

[DATE]

The Honorable Timothy F. Geithner
Secretary of the Treasury
1500 Pennsylvania Avenue NW
Washington, D.C. 20220

Re: 2012 – 13 Priority Guidance Plan Guidance under Section 414(h)(2)

Dear Secretary Geithner:

Our state and local governments, like many others, continue to find ways to address significant economic uncertainly while meeting the needs of our citizens and providing retirement security for our hardworking employees. Governments have historically had the latitude to restructure pension benefits and financing as part of their efforts to address general fiscal imbalances. In response to the unparalleled financial market decline that has impacted all investors over recent years, nearly all states and many local governments have exercised that autonomy and have made an unprecedented number of changes to their retirement systems to help ensure their long-term viability, as well as the viability of their communities at large.

For these reasons, we remain particularly concerned with certain Treasury rulings that have created significant uncertainty for governments and employees alike, and may severely limit the options available to governmental employers to make pension plan design changes at a time when such changes are essential to help alleviate competing fiscal pressures.

Immediate action by Treasury to clarify the treatment of certain arrangements under Section 414(h)(2) will enable us to continue to offer sustainable pension systems while also strengthening our overall financial conditions. In particular, this can be accomplished by issuing policy guidance to clarify and ensure the deferred tax treatment of employee pension contributions when employees are given a broadly available and durable election to participate in another tier, plan or service level within their government's defined benefit pension. We commend you for making this goal to provide policy guidance in this regard a priority in your *2012-2013 Priority Guidance Plan,* and we urge you to dedicate the staff time necessary to promptly protect the continued use of this critical and historic financial instrument for state and local governments.

We are ready to work with you and ask that you consider the unique difficulties facing states and localities, and provide us the flexibility necessary to develop long-term solutions that do not create costs for the federal government.

Sincerely,

Cc: Deputy Secretary Neal S. Wolin
Assistant Secretary Mark J. Mazur

Recent Issues with Federal Tax Treatment of Public Employee Pension Contributions

BACKGROUND

- The majority of public employees are required to share in the financing of their defined benefit (DB) pension plan – to an even greater degree in recent years.
- A special section of the federal Internal Revenue Code (Section 414(h)(2), also referred to as the "pickup" rule) permits government employee contributions to be tax-deferred if certain conditions are met.
- Treasury issued Rev. Rul. 2006-43 to clarify such conditions, including the condition that employees not be able to opt out of the tax-deferred arrangement or be able to receive contributed amounts directly instead of having them paid into the plan (in other words, employees can not be given the option between cash or deferred compensation).
- While aimed at abuses, Rev. Rul. 2006-43 has called into question the tax treatment of public employee contributions under various existing benefit structures around the country that allow state and local employees to optionally participate in a plan or tier that changes their contribution amount – which could be interpreted as giving the employee a cash or deferred option. Such benefit options can include:
  - Purchases of service credit
  - Deferred retirement option plans (DROPs)
  - Opting into another plan or tier (that has a different benefit and corresponding contribution amount)
- Prior to Rev. Rul. 2006-43, the IRS ruled favorably on tax-deferred treatment where public employees may make an irrevocable election to have contributions made to a plan on their behalf by payroll deduction. This is often done to purchase service credit under the plan (e.g. military service, service in another jurisdiction, maternity/paternity leave), to add creditable years and also to purchase credit under a different tier of the same plan. *Under the Taxpayer Relief Act of 1997, Congress stated nothing in the new purchase of service credit provisions were meant to interfere with pickups to purchase service credits. Under the Pension Protection Act of 2006, Congress specifically reaffirmed the ability of public employees to purchase service under a plan whereby "a lower level benefit is converted to a higher benefit level otherwise offered under the same plan."*
- Since Rev. Rul. 2006-43, however, there have been concerns regarding whether many of these practices would be permitted.

RECENT ACTIVITY

- Some state and local governments have recently requested a private letter ruling from Treasury, specifically with regard to providing employees a choice to opt into a new benefit plan with a different contribution level. However, these private letter ruling requests have met with resistance for various reasons:
  - Some of the requests are too unique to apply to the broad range of governments/plans that need clarification.
  - Some of the requests are from plans currently involved in litigation challenging the legality of changes made. Treasury is unlikely to issue a ruling for these plans until their litigation is resolved.

- There are national groups who believe Treasury's approval of one or more of these requests would pave the way for efforts to diminish or dismantle pension benefits. Alternatively, disapproval from Treasury could call into question long-standing tax treatment of public employee pension contributions and plans and benefits already in existence.
- Treasury's response could proscribe funding and other requirements as a condition of approval, raising concerns about federal intervention into areas of pension law that are the jurisdiction of state and local governments.

- Some state and local governments have approached members of Congress regarding a legislative alternative. However, there is an even **greater** concern that efforts to seek a federal legislative solution will invite federal mandates on the design and financing of state and local government retirement plans. House tax committee staff specifically stated they would impose onerous federal reporting and condition the tax-exempt status of state and local bonds, on any public pension legislation.

POTENTIAL SOLUTION

- Given that the current uncertainty was created by a Treasury Revenue Ruling, and the negative issues associated with a legislative fix, there is strong sentiment that the solution least likely to invite onerous federal intervention is a narrow, but broadly applicable regulatory fix.
- Treasury included issuing policy guidance "on pick-up arrangements under Section 414(h)(2)" in their 2012-2013 Priority Guidance Plan (issued November 19, 2012). That plan reflects priorities for allocation of staff resources for the current work plan year.
- One way to accomplish this would be for Treasury to clarify its Rev. Ruling 2006-43 by crafting a narrow policy solution for governmental entities pursuing pension reform that:
  - Is permissible so long as any employee election is made pursuant to a provision of federal, state, or local law (including any administrative rule or policy and any collectively bargained provision adopted in accordance with such law);
  - Continues to prohibit employees from opting out of the tax-deferred arrangement completely or receiving contributed amounts directly;
  - Is made available to all similarly situated individuals in a reasonably equivalent manner; and
  - Ensures that employees make a long-lasting election.