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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

SEP - 5 2002

UIL: 414.07-00

T:EP:RA:T3

Legend:

State A =

Plan M =

This letter is in response to a ruling request dated September 24, 2001 as supplemented by subsequent correspondence concerning whether Plan M's status as a governmental plan under section 414(d) of the Internal Revenue Code would be affected by extending Plan M to certain employees and whether such an extension would affect Plan M's status as a grandfathered plan under section 401(k)(4)(B) of the Code.

Plan M is a governmental plan, within the meaning of Code section 414(d), adopted prior to May 6, 1986, pursuant to the code of State A. Since its inception it has been maintained as a defined contribution plan with a cash or deferred arrangement meeting the requirements of section 401(a) and 401(k) of the Code. Plan M covers certain employees of State A and county boards of health. Participation is governed by statute. In the spring session of 2001, the legislature of State A amended the code of State A to permit coverage under Plan M to be extended to employees of county and independent school boards located within State A.

The constitution of State A grants authority over all local school governance to the local school boards. For purposes of the statute, independent school boards are classified with county school boards and area boards of education ("school boards") under the term "local school systems". In turn, local school systems are grouped with certain other educational boards and agencies under the title "local units of administration". The same requirements apply to all "local units of administration." Thus, under State A law, unless separately denominated, all laws affecting "county school Systems" also affect "independent school systems" in the same manner.

All entities coming under the heading of "local units of administration" are subject to certain oversight by the State A board of education and the State A school superintendent.

The code of State A provides that the members and executive officers of local governing boards shall comply with, execute and enforce all laws and all policies, rules, standards and regulations adopted by the state board of education pursuant to this article in order to be eligible to receive state funds under this article. The State A board of education provides rules on the school year, school day, school size, class size, employee work day, student discipline, suspension, expulsion, promotion, placement, state wide passing score, testing program, student assessment, text book selection etc. Under the code of State A, the State A school superintendent shall have authority to suspend a county school superintendent for incompetency, willful neglect of duty, misconduct, immorality or the commission of any crime involving moral turpitude, provided that all of his acts in this matter shall be subject to the approval of the state board and the party so suspended may appeal his case to the state board, whose decision shall be final.

Under the constitution of State A, authority is granted to county and area boards of education to maintain public schools within their limits. Each school system shall be under the management and control of a board of education, the members of which shall be elected as provided by law. School board members shall reside within the territory embraced by the school system and shall have such compensation and additional qualifications as may be provided by law.

The principal sources of funding for the school boards are local taxation under the direct control of the school boards and allocations from the general budget of State A, as approved by the legislature of State A in the annual budget process.

As indicated above, each school board is made up of members who are elected as provided by law and who reside within the territory for which the school board is responsible. Each school board, in turn, appoints a school superintendent for the district who then serves as the executive officer of the school board.

As indicated above, the school boards are "local units of administration" created by State A and under the law of State A they are recognized as agencies of State A.

The following rulings have been requested:

1. The status of Plan M as a governmental plan within the meaning of section 414(d) of the Code will not be adversely affected by the inclusion of employees of county school boards and independent school boards in that plan.

2. The extension of Plan M to cover county school boards and independent boards of education will not violate section 401(k)(4)(B) of the Code nor cause Plan M to lose its grandfathered status under section1116(f)(2)(B)(i) of the Tax Reform Act of 1986.

Section 414(d) of the Code provides that a governmental plan means a plan established and maintained for its employees by the government of the United States, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

Revenue Ruling 89-49, 1989-1 C.B. 117, provides that a plan will not be considered a governmental plan merely because the sponsoring organization has a relationship with a governmental unit or some quasi-governmental power. It holds that one of the most important factors to be considered in determining whether an organization is an agency or instrumentality of the United States or any state or political subdivision thereof is the degree of control that the state or federal government has over the organization's everyday operations. Other factors listed in Revenue Ruling 89-49 include: (1) whether there is specific legislation creating the organization; (2) the source of funds for the organization; (3) the manner in which the organization's trustees or operating board are selected; and (4) whether the applicable governmental unit considers the employees of the organization to be employees of the applicable governmental unit. Although all of the above factors are considered in determining whether an organization is an agency of a government, the mere satisfaction of one or all of the factors is not necessarily determinative.

Based on the above facts pertaining to the control that the State A board of education and State A school superintendent have over the school boards, the specific state law creating the school boards, the source of the school boards' funding and the election of the school boards' members, we have determined that the school boards are an agency of a government within the meaning of Revenue Ruling 89-49. Accordingly, it is concluded as follows:

The status of Plan M as a governmental plan within the meaning of section 414(d) of the Code will not be adversely affected by the inclusion of employees of county school boards and independent school boards in that plan

Section 401(k) sets forth the requirements for a qualified cash or deferred arrangement. Section 401(k)(2) provides, in part, that a qualified cash or deferred arrangement is any arrangement which is part of a profit sharing plan which meets the requirements of section 401(a) under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash.

Section 401(k)(4)(B)(ii) of the Code provides that a cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a state or local government or a political subdivision thereof, or any agency or instrumentality thereof (a "governmental unit"). Prior to being amended by the Tax Reform Act of 1986 ("TRA"), section 401(k) permitted such governmental units to maintain a qualified cash or deferred arrangement. Section 1116(f)(2)(B)(i) of TRA provides that section 401(k)(4)(B) does not apply to cash or deferred arrangements adopted by a governmental unit before May 6, 1986.

Section 1.401(k)-1(e)(4)(ii) of the Income Tax Regulations provides that a cash or deferred arrangement maintained by a governmental unit is treated as adopted after May 6, 1986, with respect to all employees of any employer that adopts the arrangement after that date. However, if an employer adopted an arrangement prior to that date, all employees of the employer may participate in the arrangement.

Section 1.401 (k)-1(g)(6) of the regulations provides as a definition of the word "employer" for 401(k) plans, that the term means the employer within the meaning of section 1.410(b)-9 of the regulations.

Section 1.410(b)-9 of the regulations states that the term "employer" means the employer maintaining the plan and those employers required to be aggregated with the employer under section 414(b), (c), (m), or (o) of the Code.

It is represented that State A has timely adopted Plan M for purposes of section 1116(f)(2)(B) of TRA. However, a ruling that Plan M may cover county school boards and independent boards of education, without failing to comply with section 401(k)(4)(B), depends on a determination that such employers are required to be aggregated with State A under Code section 414(b) or (c).

Announcement 95-48, 1995-23 I.R.B. 13, extended the effective date of certain nondiscrimination rules for qualified plans maintained by governments or by organizations exempt from income tax under section 501 (a) of the Code. Announcement 95-48 provides that the Service and Treasury recognize "that difficult issues arise for governmental and tax-exempt employers in determining which entities must be aggregated under sections 414(b) and (c) (relating to the definition of employer). Until further guidance is issued, governmental and tax-exempt employers may apply a reasonable, good faith interpretation of sections 414(b) and (c) in determining which entities must be aggregated."

In Notice 96-64, 1996-2 C.B. 229, the Service addresses certain issues relating to the nondiscrimination rules that apply to qualified plans maintained by governments and by tax-exempt organizations. Section VII of Notice 96-64 provides that, until further guidance is issued, governments and tax-exempt organizations may apply a reasonable, good faith interpretation of existing law in determining which entities must be aggregated under section 414(b) and (c). The notice also provides that when further guidance is issued, it will be applied on a prospective only basis and will not be effective before plan years beqinninq in 2001. Section VII of Notice 96-64 also requests comments on an appropriate aggregation standard for tax-exempt organizations under sections 414(b), (c), and (o) of the Code.

Section 6.03 of Revenue Procedure 2002-4, 2002-1 I.R.B. 127, provides that the Service ordinarily will not issue letter rulings on matters involving a plan's qualified status under Code sections 401 through 420 and section 4975. However, this section further provides that letter rulings may be issued in three limited circumstances: (1) when the taxpayer has demonstrated to the Service's satisfaction that the qualification issue involved is unique and requires immediate guidance; (2) when, as a practical matter, it is not likely that such issue will be addressed through the determination letter process; and, (3) when the Service determines that it is in the interest of sound tax administration to provide guidance to the taxpayer with respect to such qualification issue.

Section 8.01 of Rev. Proc. 2002-4 provides that the Service ordinarily will not issue a letter ruling in certain areas because of the factual nature of the problem involved or

because of other reasons. The Service may decline to issue a letter ruling when appropriate in the interest of sound tax administration or on other grounds whenever warranted by the facts or circumstances of a particular case.

Pursuant to Rev. Proc. 2002-4, we will not issue letter rulings involving issues relating to the aggregation of government entities under section 414(b) or (c) of the Code until guidance is issued. Accordingly, we will not issue a ruling in response to your second ruling request. However, taxpayers may apply a reasonable, good faith interpretation of existing law in determining which entities must be aggregated under sections 414(b) and (c).

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

This letter ruling was written by of this Group who can be reached at .

Copies of this letter have been sent to two of your authorized representatives in accordance with a power of attorney submitted with the request.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3
Tax Exempt and Government Entities Division

Enclosures:
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Notice 437