

Rule Summary and Fiscal Analysis (Part A)**Public Employees Retirement System**

Agency Name

Division

Julie Emch Becker

Contact

277 East Town St. Columbus OH 43215-4642

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145-4-02

Rule Number

AMENDMENT

TYPE of rule filing

Rule Title/Tag Line

Health care fund.**RULE SUMMARY**

1. Is the rule being filed for five year review (FYR)? **No**
2. Are you proposing this rule as a result of recent legislation? **No**
3. Statute prescribing the procedure in accordance with the agency is required to adopt the rule: **111.15**
4. Statute(s) authorizing agency to adopt the rule: **145.09, 145.58**
5. Statute(s) the rule, as filed, amplifies or implements: **145.58, 145.584**
6. State the reason(s) for proposing (i.e., why are you filing,) this rule:

This rule is being proposed to complete the termination of the 401(h) Accounts and document the Board's authority to act on behalf of the contributing employers to hold and credit health care contributions to OPERS' newer 115 Trust. Several amendments were filed as an emergency on April 20, 2016. The original filing of those amendments was withdrawn so that additional amendments could be incorporated prior to the June 30, 2016 closure of the accounts. This action is taken pursuant to specific written guidance from the IRS on the appropriate process to terminate and transfer assets in these funds.

7. If the rule is an AMENDMENT, then summarize the changes and the content of the proposed rule; If the rule type is RESCISSION, NEW or NO CHANGE, then summarize the content of the rule:

The amendments to this rule provide for the closure of the current health care funding trusts and transfer of their assets to a new health care funding trust.

8. If the rule incorporates a text or other material by reference and the agency claims the incorporation by reference is exempt from compliance with sections 121.71 to 121.74 of the Revised Code because the text or other material is **generally available** to persons who reasonably can be expected to be affected by the rule, provide an explanation of how the text or other material is generally available to those persons:

This rule references sections of the Ohio Revised and Administrative Codes, and the Internal Revenue or United States Code. The ORC, OAC, USC, and IRC are generally available in libraries and on the internet.

9. If the rule incorporates a text or other material by reference, and it was **infeasible** for the agency to file the text or other material electronically, provide an explanation of why filing the text or other material electronically was infeasible:

Ohio Revised Code 121.76 exempts agencies from filing copies of the codes cited in the text of a rule.

10. If the rule is being **rescinded** and incorporates a text or other material by reference, and it was **infeasible** for the agency to file the text or other material, provide an explanation of why filing the text or other material was infeasible:

Not Applicable.

11. If **revising** or **refiling** this rule, identify changes made from the previously filed version of this rule; if none, please state so. If applicable, indicate each specific paragraph of the rule that has been modified:

Not Applicable.

12. Five Year Review (FYR) Date: **9/29/2018**

(If the rule is not exempt and you answered NO to question No. 1, provide the scheduled review date. If you answered YES to No. 1, the review date for this

rule is the filing date.)

NOTE: If the rule is not exempt at the time of final filing, two dates are required: the current review date plus a date not to exceed 5 years from the effective date for Amended rules or a date not to exceed 5 years from the review date for No Change rules.

FISCAL ANALYSIS

13. Estimate the total amount by which *this proposed rule* would **increase / decrease** either **revenues / expenditures** for the agency during the current biennium (in dollars): Explain the net impact of the proposed changes to the budget of your agency/department.

This will have no impact on revenues or expenditures.

Not Applicable

Not Applicable

14. Identify the appropriation (by line item etc.) that authorizes each expenditure necessitated by the proposed rule:

Not Applicable

15. Provide a summary of the estimated cost of compliance with the rule to all directly affected persons. When appropriate, please include the source for your information/estimated costs, e.g. industry, CFR, internal/agency:

Not Applicable

16. Does this rule have a fiscal effect on school districts, counties, townships, or municipal corporations? **No**

17. Does this rule deal with environmental protection or contain a component dealing with environmental protection as defined in R. C. 121.39? **No**

S.B. 2 (129th General Assembly) Questions

18. Has this rule been filed with the Common Sense Initiative Office pursuant to R.C. 121.82? **No**

19. Specific to this rule, answer the following:

A.) Does this rule require a license, permit, or any other prior authorization to engage in or operate a line of business? **No**

B.) Does this rule impose a criminal penalty, a civil penalty, or another sanction, or create a cause of action, for failure to comply with its terms? **No**

C.) Does this rule require specific expenditures or the report of information as a condition of compliance? **No**

**OHIO PUBLIC EMPLOYEES RETIREMENT SYSTEM
TRUST AGREEMENT FOR FUNDING EMPLOYEE BENEFIT PLANS**

THIS TRUST AGREEMENT ("Agreement") is made and entered into on August 20th, 2014 (the "Effective Date") by and between the Public Employees Retirement Board (the "Board of Trustees") acting on behalf of the Ohio Public Employees Retirement System ("OPERS"), and the Board of Trustees acting as Trustee of the trust established by the Agreement (the "Trust").

WITNESSETH:

WHEREAS, OPERS maintains or will maintain one or more health care plans (the "Plan") to provide health benefits to certain of its members and their dependents (collectively referred to as the "Participants"); and

WHEREAS, to provide funding for such health benefits, the Board of Trustees directs and manages a portion of employer contributions; and

WHEREAS, the Board of Trustees desires to establish the Trust to receive employer contributions to fund the Plan and any other amounts that may be contributed to the Trust consistent with applicable law; and

WHEREAS, amounts contributed to the Trust, the terms of which are established by this Agreement, will constitute the assets of the Trust; and

WHEREAS, the Board of Trustees or its duly authorized delegate shall be responsible for the administration of the Trust; and

WHEREAS, the Board of Trustees intends that the Trust be used to help perform OPERS's essential governmental function of providing, in its sole discretion, various retiree health benefits to Participants pursuant to applicable law and that all income derived from the assets of the Trust qualify for exclusion from federal income taxation under Section 115 of the Internal Revenue Code of 1986, as amended (the "Code").

NOW THEREFORE, in consideration of the mutual covenants herein contained, the Board of Trustees hereby establishes the terms of the Trust as follows:

ARTICLE I CONTRIBUTIONS

- 1.1 Contributions.** OPERS, which acts through its Board of Trustees of its delegate, may contribute, from time to time, amounts received as employer contributions to the Trust. OPERS may, in its sole discretion, contribute any other amounts to the Trust as may be permissible under applicable law and to the extent approved by the Board of Trustees. Contributions shall be made to the Trust on a periodic basis or in a lump-sum in the sole discretion of OPERS. OPERS shall not be required to make contributions unless (and only to the extent) it has obligated itself to do so by resolution.
- 1.2 Receipt of Contributions.** The Trustee shall accept all sums of moneys and other acceptable property contributed to the Trust as property of the Trust. All contributions so received, together with the income therefrom and any other increment thereon, shall be held, invested, reinvested and managed, disbursed, and administered by the Trustee in accordance with the provisions of this Agreement for the exclusive benefit of Participants. The Board of Trustees shall be responsible for the calculation or collection of any employer contributions consistent with Chapter 145 of the Ohio Revised Code and any rules adopted thereunder and shall also be responsible only for property received by the Trust pursuant to this Agreement.
- 1.3 Compliance with Laws.** This Agreement and Trust are intended to meet the requirements of Code section 115, the Ohio Revised Code, including, but not limited to the provisions of Chapter 145 thereof that apply to OPERS, and any other applicable laws or regulations.

ARTICLE II
PAYMENTS FROM THE TRUST

- 2.1** **Payments from Trust Assets.** Payments shall be made from time to time out of the Trust, in such amounts as directed by the person responsible for the administration of the Plan, to reduce health benefit premiums, health benefit costs, or health benefit premium contributions, copayments, deductibles, coinsurance, or other out-of-pocket costs; or any combination of these costs, or as otherwise required or permitted by the Plan.

ARTICLE III INVESTMENTS

- 3.1 **General.** The Trustee shall have exclusive authority, discretion and responsibility for the investment of the principal and income of the Trust and to keep the Trust invested without distinction between principal and income, in such securities, commodities, or other investment interests, or in such property, real or personal, tangible or intangible, as the Trustee shall deem advisable, including, without limitation, insurance company annuities or investment contracts, stocks, common or preferred, trust and participation certificates, interests in common or collective investment vehicles, investment companies, including mutual funds, bonds, debentures, notes, mortgages or other evidences of indebtedness or ownership, savings accounts and certificates, real estate mortgages and any other kind of property.
- 3.2 **Delegation.** The Trustee may delegate investment authority over the assets of the Trust to an individual, committee or organization as it sees fit. Any delegation by the Trustee under this section may require the delegated individual, committee, or organization to purchase fiduciary liability insurance to cover the liability or losses occurring by reason of the act or omission of such fiduciary.
- 3.3 **Investment Guidelines.** To the extent it deems it appropriate, the Trustee may establish an investment policy and guidelines ("Investment Guidelines") appropriate for the assets of the Trust and shall review such policy and guidelines from time to time as it deems necessary.
- 3.4 **Investment Managers.** The Trustee may appoint one or more investment managers to invest all or part of the Trust consistent with the established Investment Guidelines or such other guidelines as may be established for such investment manager(s). To the extent that the Trustee has selected an investment manager consistent with the applicable fiduciary duties under Ohio law, if any, the Trustee shall not be liable for any act or omission of such manager and shall not be otherwise responsible for the investment of funds allocated to such manager.

**ARTICLE IV
POWERS OF THE TRUSTEE**

4.1 Powers. Except as otherwise provided herein, with respect to the Trust, the Trustee shall possess, and may exercise in its discretion, all the powers and authorities under common law and by way of illustration and not limitation, the Trustee is empowered and authorized to do the following:

- (a) purchase, or subscribe for, any securities or other property and to retain the same in trust;
- (b) sell, exchange, convey, transfer, grant options to purchase, or otherwise dispose of any securities or other property held by the Trust, by private contract or at public auction, and any sale may be made for cash or upon credit, or partly for cash and partly upon credit. No person dealing with the Trustee shall be bound to see to the application of the purchase money or to inquire into the validity, expediency, or propriety of any such sale or other disposition;
- (c) vote upon any stocks, bonds, or other securities; to give general or special proxies or powers of attorney with or without power of substitution; to exercise any conversion privileges, subscription rights, or other options, and to make any payments incidental thereto; to oppose, or to consent to, or otherwise participate in, corporate reorganizations or other changes affecting corporate securities, and to delegate discretionary powers, and to pay any assessments or charges in connection therewith; and generally to exercise any of the powers of an owner with respect to stock, bonds, securities, or other property held as part of the Trust;
- (d) cause any securities or other property held as part of the Trust to be registered in the Trustee's name and to hold any investments in bearer form, but the books and records of the Trustee shall at all times show that all investments are part of the Trust;
- (e) borrow or raise money for the purposes of this Trust in such amount, and upon such terms and conditions as the Trustee shall deem advisable; and for any sum so borrowed, to issue a promissory note as the Trustee, and to secure the repayment thereof by pledging all, or any part, of the Trust; and no person lending money to the Trustee shall be bound to see to the application of the money loaned or to inquire into the validity, expediency, or propriety of any borrowing;
- (f) keep such portion of the Trust in cash or cash balances as the Trustee may, from time to time, deem to be in the best interests of the Trust, without liability for interest thereon;

- (g) accept and retain for such time as it may deem advisable any securities or other property received or acquired by it as the Trustee, whether or not such securities or other property would normally be purchased as investments hereunder;
- (h) deposit any part or all of the assets of the Trust in any medium for collective investment and to withdraw any part or all of the assets so deposited. So long as any portion of the Trust is invested in any such collective trust fund, the trust instrument establishing such collective trust fund (including any amendments thereto) shall be deemed to have been adopted and made a part of this Agreement;
- (i) make, execute, acknowledge, and deliver any and all documents of transfer and conveyance and any and all other instruments that may be necessary or appropriate to carry out the powers herein granted;
- (j) settle, compromise, or submit to arbitration any claims, debts, or damages to or owing to or from the Trust, to commence or defend suits or legal or administrative proceedings, and to represent the Trust in all suits and legal and administrative proceedings;
- (k) employ suitable agents and counsel and to pay their reasonable expenses and compensation;
- (l) acquire real estate by purchase, exchange, or as the result of any foreclosure, liquidation, or other salvage as the result of any foreclosure, liquidation, or other salvage of any investment previously made hereunder; to hold such real estate in such manner and upon such terms as the Trustee may deem advisable; and to manage, operate, repair, develop, improve, partition, mortgage, or lease for any terms of years any such real estate or any other real estate constituting a part of the Trust, upon such terms and conditions as the Trustee deems proper, using other Trust assets for any of such purposes if deemed advisable;
- (m) invest funds of the Trust in night deposits or savings accounts bearing a reasonable rate of interest;
- (n) invest in Treasury Bills and other forms of United States government obligations;
or
- (o) do all such acts, take all such proceedings, and exercise all such rights and privileges, although not specifically mentioned herein, as the Trustee may deem necessary to administer the Trust, and to carry out the purposes of this Trust Agreement.

ARTICLE V TRUSTEE'S DUTIES

- 5.1 **General.** The Trustee shall discharge its duties under this Agreement solely in the interest of the Participants and for the exclusive purpose of providing benefits to such persons and defraying reasonable expenses of administering the Plan and the Trust. The duties and obligations of the Trustee under this Agreement shall be limited to those expressly imposed upon it by this Agreement, notwithstanding any reference herein to the Plan or the provisions thereof. The Trustee may delegate any or all of its right or obligations hereunder to OPERS staff subject to the continuing oversight of the Trustee. Any actions and/or inactions of such delegate shall have the same effect as if taken or not taken by the Trustee itself.
- 5.2 **Consultation.** The Trustee may consult with counsel and the Trustee shall not be deemed imprudent by reason of taking or refraining from taking any action in accordance with the opinion of counsel. The Trustee shall not be required to give any bond or any other security for the faithful performance of its duties under this Agreement, except such as may be required by a law which prohibits the waiver thereof.
- 5.3 **Financial Reports.** The Trustee shall maintain accurate and detailed accounts of all investments, receipts, disbursements, and other transactions hereunder and such records shall be made accessible to any person entitled to review such records under any applicable law. The Trustee shall maintain such accountings as may be required under applicable law.
- 5.4 **Limitation on Trustee's Responsibilities.** Except as required by Ohio law or pursuant to a separate agreement, the Trustee shall not be responsible in any respect for administering the Plan except as may be provided pursuant to this Agreement or any other agreement entered into by the Trustee.
- 5.5 **Indemnification.**
- (a) Indemnification by the Trust. To the extent permitted by applicable law and subject to the limitations described in this Section 5.5, each current and former member of the Board of Trustees, each current and former administrator of the Plan, and all persons formerly serving in such capacities ("Covered Persons") shall be indemnified and saved harmless by the Trust from and against any and all claims of liability arising in connection with the exercise of their duties and responsibilities with respect to the Plan and the Trust, including all expenses reasonably incurred in the defense of such act or omission, unless (1) it is established by final judgment of a court of competent jurisdiction that such act or omission involved a violation of the duties imposed by applicable law or gross negligence or willful misconduct on the part of such Covered Person; or (2) in the event of settlement or other disposition of a claim involving the Plan, it is determined by written opinion of independent counsel that such act or omission

involved a violation of duties imposed by applicable law or gross negligence or willful misconduct on the part of such Covered Person.

To the extent permitted by applicable law, all expenses (including reasonable attorneys fees and disbursements), judgments, fines and amounts paid in settlement incurred by the Covered Person in connection with any of the proceedings described above shall be paid from the Trust, provided that (1) the Covered Person shall repay such advances to the Trust, with reasonable interest, if it is established by final judgment of a court of competent jurisdiction that such act or omission involved a violation of the duties imposed by applicable law or gross negligence or willful misconduct on the part of such Covered Person, and (2) the Covered Person shall provide a bond, letter of credit or make other appropriate arrangements for repayment of advances. Notwithstanding the foregoing, no such advances shall be made in connection with any claim against the Covered Person that is made by the Plan or the Board of Trustees, provided that upon the final disposition of such claim, the expenses (including reasonable attorneys fees and disbursements), judgments, fines, and amounts paid in settlement shall be reimbursed by the Trust to the extent provided above.

The indemnification provided under this Section 5.5(a) applies only to claims and expenses not actually covered by insurance.

- (b) Indemnification by OPERS. To the extent not covered by insurance or reimbursed by the Trust as provided in Section 5.5(a), OPERS indemnifies each current and former member of the Board of Trustees, each current and former administrator of the Plan, and each member or employee of OPERS, and all persons formerly serving in such capacity, acting on behalf of the Plan, against any and all liabilities or expenses, including all legal fees relating thereto, arising in connection with the exercise of their duties and responsibilities with respect to the Plan or the Trust, provided however that OPERS does not indemnify any person for liabilities or expenses due to that person's own gross negligence or willful misconduct.

ARTICLE VI
TRUSTEE

- 6.1 **Members and Acts.** All members of the Public Employees Retirement Board shall be members of the Trustee for purposes of this Agreement. All additional or successor individual Board of Trustees members shall become a party to this Agreement and shall act in accordance with the terms contained herein. The Trustee shall act only as a Board and not individually unless it has delegated its authority as permitted herein. Actions of the Trustee shall be governed by the same rules and requirements as apply to the administration of the OPERS retirement plans.

**ARTICLE VII
AMENDMENT AND TERMINATION**

- 7.1 **Amendment.** Except as otherwise provided herein, any or all of the provisions of this Agreement may be amended by the Board of Trustees, in whole or in part, by an instrument in writing.
- 7.2 **Termination.** This Agreement shall terminate on the earlier of: (a) the death of the last remaining Participant, (b) the lawful termination of the Plan, (c) the depletion of the Trust, or (d) in the event the Internal Revenue Service does not issue a favorable private letter ruling that income of the Trust will be excludable from gross income under IRC section 115. The Board of Trustees may also terminate this Agreement at any time; provided, however, that upon termination for any reason, any amounts remaining in the Trust shall revert to a vehicle designated by the Board of Trustees.
- 7.3 **Exclusive Benefit.** Except as otherwise provided herein or as otherwise permitted by applicable law, no part of the Trust shall at any time revert to an employer or OPERS or be used for or diverted to purposes other than for the exclusive benefit of Participants or the payment of reasonable expenses of the Plan or Trust.

**ARTICLE VIII
GENERAL**

- 8.1 **Expenses.** The Trustee may, to the extent consistent with any applicable legal requirement, be reimbursed for expenses reasonably incurred by it in the administration of the Trust. All such expenses, including, without limitation, reasonable fees of accountants, actuaries, and legal counsel to the extent not otherwise reimbursed, shall, to the extent permitted by applicable law, constitute a charge against and shall be paid from the Trust upon the direction of the Trustee.
- 8.2 **Limited Effect of Plan and Trust.** Neither the establishment of the Plan and the Trust or any modification thereof, the creation of any fund or account, nor the payment of any benefits, shall be construed as giving to any person covered under the Plan or other person any legal or equitable right against OPERS, the Board of Trustees, or any officer or employee thereof, except as may otherwise be expressly provided in the Plan or this Agreement. In no event does any term of this Agreement create a right that is vested in a member or any other person and, as provided in Article VII is subject to amendment or discontinuance at any time.
- 8.3 **Protective Clause.** OPERS, the Board of Trustees, and OPERS' officers and employees shall not be responsible for the validity of any contract of insurance or other arrangement maintained in connection with the Plan, or for the failure on the part of the insurer or provider to make payments provided by such contract, or for the action of any person which may delay payment or render a contract void or unenforceable in whole or in part.
- 8.4 **Construction of Agreement.** This Agreement shall be construed and enforced according to the laws of Ohio. If any provision of this Trust shall be held illegal or invalid for any reason, such determination shall not affect the remaining provisions of this Agreement and the remaining provisions shall be construed to effectuate the purpose of this Agreement.
- 8.5 **Gender and Number.** Wherever any words are used herein in the masculine, feminine, or neutral, they shall be construed as though they were also used in another gender in all cases where they would so apply, and whenever any words are used herein in the singular or plural form, they should be construed as though they were also used in the other form in all cases where they would so apply.
- 8.6 **Headings.** The headings and sub-headings of this Agreement have been inserted for convenience of reference and are to be ignored in any construction of the provisions hereof.
- 8.7 **Delegation.** The Trustee may delegate any and/or all of its authority under this Agreement to an employee or officer of OPERS. Any actions and/or inactions of such delegatee shall have the same effect as if taken or not taken by the Trustee itself.

IN WITNESS WHEREFORE, this Agreement has been executed effective as of the Effective Date.

Karen E. Carraher

Karen Carraher, Executive Director of the
Ohio Public Employees Retirement System

8-20-14

Date

Authorized Representative of the Public
Employees Retirement Board of Trustees

**Amendment One to the
Ohio Public Employees Retirement System
Trust Agreement for Funding Employee Benefit Plans**

WHEREAS, the Ohio Public Employees Retirement System Trust Agreement for Funding Employee Benefit Plans ("Trust Agreement") was adopted by the Board on August 20, 2014;

WHEREAS, the Ohio Public Employees Retirement Board, as Trustees of the Trust Agreement ("Trustees"), reserved the right to amend the Trust Agreement pursuant to Section 7.1 of the Trust Agreement;

WHEREAS, the Trustees now desire to amend the Trust Agreement;

NOW, THEREFORE, the Trust Agreement is hereby amended as follows:

1. Section 7.2 of the Trust Agreement, describing termination is hereby amended to be and read as follows:

This Agreement shall terminate on the earlier of: (a) the death of the last remaining Participant, (b) the lawful termination of the Plan, (c) the depletion of the Trust, or (d) in the event the Internal Revenue Service does not issue a favorable private letter ruling that income of the Trust will be excludable from gross income under IRC section 115. The Board of Trustees may also terminate this Agreement at any time; provided, however, that upon termination for any reason, any amounts remaining in the Trust shall revert to a vehicle designated by the Board of Trustees, and in no case will the Trust's assets be distributed to an entity that is not a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under IRC section 115.

2. In all other respects, the Trust Agreement shall be and remain unchanged.

IN WITNESS WHEREOF the undersigned has executed this Amendment on the date indicated:

Karen E. Carraher
Karen E. Carraher, Executive Director of the
Ohio Public Employees Retirement System

11-26-14
Date

Authorized Representative of the Public
Employees Retirement Board of Trustees

**Amendment Two to the
Ohio Public Employees Retirement System
Trust Agreement for Funding Employee Benefit Plans**

WHEREAS, the Ohio Public Employees Retirement System Trust Agreement for Funding Employee Benefit Plans ("Trust Agreement") was adopted by the Board on August 20, 2014;

WHEREAS, the Ohio Public Employees Retirement Board, as Trustees of the Trust ("Trustees"), reserved the right to amend the Trust Agreement pursuant to Section 7.1 of the Trust Agreement;

WHEREAS, the Trustees now desire to amend the Trust Agreement to reflect the name of the Trust as the OPERS TR AGREEMENT FOR FUNDING EMPLOYEE BENEFIT PLANS;

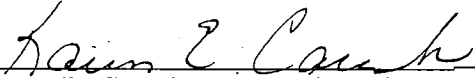
NOW, THEREFORE, the Trust Agreement is hereby amended as follows:

1. The introductory paragraph is deleted in its entirety and replaced with the following:

THIS TRUST AGREEMENT ("Agreement") is made and entered into on August 20th, 2014 (the "Effective Date") by and between the Public Employees Retirement Board (the "Board of Trustees") acting on behalf of the Ohio Public Employees Retirement System ("OPERS") and the Board of Trustees acting as Trustee of the OPERS TR AGREEMENT FOR FUNDING EMPLOYEE BENEFIT PLANS (the "Trust"), established by the Agreement.

2. In all other respects, the Trust Agreement shall be and remain unchanged.

IN WITNESS WHEREOF the undersigned has executed this Amendment on the date indicated:



Karen E. Carraher, Executive Director of the
Ohio Public Employees Retirement System

2-20-15
Date

Authorized Representative of the Public
Employees Retirement Board of Trustees

Index Number: 4976.01-00, 401.27-00,
4980.00-00

Third Party Communication: None
Date of Communication: Not Applicable

Julie Becker, General Counsel
Public Employees Retirement System of Ohio
277 East Town Street
Columbus, OH 43215-4642

Person To Contact:
Stephanie Caden
Telephone Number:
(202) 317-5500
Refer Reply To:
CC:TEGE:EB:HW
PLR-131579-15

Date:

MAR 7 2016

LEGEND:

- Taxpayer = Ohio Public Employees Retirement System
- State = Ohio
- HRA Plan = Public Employees Retirement System of Ohio Health Reimbursement Arrangement Plan
- Health Plan = Public Employees Retirement System of Ohio VEBA Health Plan
- Trust A = Public Employees Retirement System of Ohio VEBA Trust
- Trust B = Ohio Public Employees Retirement System Agreement for Funding Employee Benefit Plans
- Month Y = October 2015

Dear Ms. Becker:

This responds to your letter of September 25, 2015, and subsequent correspondence, requesting a ruling regarding the tax consequences under sections 401(h), 4980 and 4976 of the Internal Revenue Code (Code) of the return of assets from section 401(h) accounts to Taxpayer and the transfer of assets from Trust A to Trust B.

FACTS

Taxpayer is a state public employees' retirement system that is an instrumentality of State. You represent that Taxpayer is exempt from Federal income tax under section 115. Taxpayer operates three retirement plans whose participants are retired public employees: a traditional defined benefit plan (Traditional Plan), a defined benefit plan with elements of a defined contribution plan (Combined Plan), and a defined contribution plan (Member-Directed Plan). You represent that each of these retirement plans qualifies as a governmental plan pursuant to section 414(d) of the Code, and

each of the plans meets the requirements of section 401(a) that apply to governmental plans.

Taxpayer provides retiree health benefits to eligible retirees in the Traditional Plan and the Combined Plan through section 401(h) accounts, and beginning in Month Y, through Trust B, which you represent is a section 115 trust, the income of which is excludable from gross income under section 115(1) of the Code. Taxpayer also provides retiree health benefits to eligible retirees in the Member-Directed Plan under Health Plan through Trust A, which you represent is a voluntary employees' beneficiary association described in section 501(c)(9) of the Code (VEBA). Taxpayer is terminating its current health plans for retirees in the Traditional and Combined Plans and creating a new pre-Medicare plan and a new post-Medicare health reimbursement arrangement. To fund the Health Plan, the Traditional and Combined plans will return the section 401(h) account assets to Taxpayer upon satisfying all medical benefit liabilities under the Traditional and Combined Plans, and Taxpayer will transfer the amounts to Trust B. Taxpayer will also terminate Trust A and transfer Trust A's assets to Trust B. Following the transfer, Health Plan will be funded solely through Trust B. Neither Taxpayer nor any other contributing employer have ever taken an income tax deduction for any contributions to Trust A under section 419 or any other section of the Code.

When the section 401(h) accounts terminate, Taxpayer represents that the amounts credited to the section 401(h) accounts will revert back to Taxpayer, both in its capacity as a contributing employer and as an agent of the other contributing employers. Taxpayer will structure the reversions from each of the section 401(h) accounts as credits back to the contributing employers and will assess the employers a contribution due to Trust B in an equal amount. Taxpayer has provided a proposed rule change to State's administrative code granting Taxpayer authority to act on its own behalf and as the contributing employers' agent for purposes of terminating the section 401(h) accounts and contributing the reverted amounts to Trust B. Taxpayer also represents the proposed transactions will not take place until after the proposed rule change is adopted in the State's administrative code.

RULINGS REQUESTED

1. The return of the section 401(h) account assets to Taxpayer will not result in a failure of the Traditional Plan or the Combined Plan to satisfy the requirements of section 401(h);
2. Taxpayer will not be subject to the excise tax under section 4980 as a result of the return of the section 401(h) account assets to the Taxpayer; and
3. The transfer of assets from Trust A to Trust B upon termination of Trust A will not result in a "disqualified benefit" within the meaning of section 4976(b)(1)(C), and will not, in and of itself, cause Taxpayer to be liable for excise tax under section 4976.

LAW

Section 401(a) of the Code describes requirements for a qualified trust that is created or organized in the United States and forms part of a pension plan of an employer that is for the exclusive benefit of the employer's employees or their beneficiaries. Section 501(a) provides in pertinent part that an organization described in section 401(a) is generally exempt from income tax.

In pertinent part, section 401(h) provides that, under regulations prescribed by the Secretary, and subject to the provisions of section 420, a pension or annuity plan may provide for the payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses and their dependents, but only if –

- (1) such benefits are subordinate to the retirement benefits provided by the plan,
- (2) a separate account is established and maintained for such benefits,
- (3) the employer's contributions to such separate account are reasonable and ascertainable,
- (4) it is impossible, at any time prior to the satisfaction of all liabilities under the plan to provide such benefits, for any part of the corpus or income of such separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits, and
- (5) upon the satisfaction of all liabilities under the plan to provide such benefits, any amount remaining in such separate account must, under the terms of the plan, be returned to the employer.

Section 1.401-14(a) of the Income Tax Regulations provides that, under section 401(h), a qualified pension or annuity plan may make provision for the payment of sickness, accident, hospitalization, and medical expenses for retired employees, their spouses, and their dependents. The term "medical benefits described in section 401(h)" is used in this section to describe such payments.

Section 1.401-14(c)(5) of the Income Tax Regulations provides that, under section 401(h), a qualified pension or annuity plan must provide that any amounts which are contributed to fund medical benefits described in section 401(h) and which remain in the medical benefits account upon satisfaction of all liabilities arising out of the operation of the medical benefits portion of the plan are to be returned to the employer.

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.

Section 4(b)(1) of the Employee Retirement Income Security Act of 1974 (ERISA) provides that Title I of ERISA does not apply to governmental plans as defined in section 3(32) of ERISA. Section 3(32) of ERISA provides that a "governmental plan" means a plan established or maintained for its employees by the Government of the United States, by the government of any state or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.¹

Section 419(a) of the Code provides that contributions paid or accrued by an employer to a welfare benefit fund are not deductible under Chapter 1, but if they would otherwise be deductible, are (subject to the limitation of section 419(b)) deductible under section 419 for the taxable year in which paid.

Section 419(e)(1) defines "welfare benefit fund" as any fund which is part of a plan of an employer, and through which the employer provides welfare benefits to employees or their beneficiaries. Pursuant to section 419(e)(3), the term "fund" includes any organization described in section 501(c)(9) of the Code.

Section 4976(a) of the Code imposes a 100 percent excise tax if an employer maintains a welfare benefit fund and there is a disqualified benefit provided during any taxable year.

Section 4976(b)(1)(C) defines "disqualified benefit" to include any portion of a welfare benefit fund reverting to the benefit of the employer. Section 4976(b)(3) provides that section 4976(b)(1)(C) does not apply to any amount attributable to a contribution to the fund which is not allowable as a deduction under section 419 for the taxable year or any prior taxable year (and such contribution will not be included in any carryover under section 419(d)).

Section 4980(a) provides for a 20% excise tax on the amount of any employer reversion from a qualified plan. Section 4980(d) provides that section 4980(a) will be applied by substituting "50 percent" for "20 percent" with respect to any employer reversion from a qualified plan unless (A) the employer establishes or maintains a qualified replacement plan under section 4980(d)(2), or (B) the plan provides benefit increases meeting the requirements of section 4980(d)(3). Section 4980(c)(1)(B) provides that for purposes of section 4980, a "qualified plan" does not include a governmental plan (within the meaning of section 414(d) of the Code).

ANALYSIS

Taxpayer has represented that when the section 401(h) accounts terminate, the amounts credited to the section 401(h) accounts will revert back to Taxpayer, both in its capacity as a contributing employer and as an agent of the other contributing employers (all of which are instrumentalities of State). Taxpayer further represents that it will

¹ Title I of ERISA is generally interpreted and administered by the U.S. Department of Labor. See ERISA section 505 and Reorganization Plan No. 4 of 1978, 43 Fed. Reg. 47713 (Oct. 17, 1978).

structure the reversions from each of the section 401(h) accounts as credits back to the contributing employers and will assess the employers a contribution due to Trust B in an equal amount. Taxpayer has provided a proposed rule change to State's administrative code granting authority to Taxpayer to act on its own behalf and as the contributing employers' agent for purposes of terminating the section 401(h) accounts and contributing the reverted amounts to Trust B. Taxpayer also represents the proposed transactions will not take place until after such authority is granted. Based on these facts and representations, the return of the section 401(h) account assets to the Taxpayer will not violate section 401(h) and section 1.401-14 of the Income Tax Regulations.

The two section 401(h) accounts from which Taxpayer is receiving a reversion are part of the Traditional Plan and the Combined Plan respectively, both of which are governmental plans within the meaning of section 414(d). Pursuant to section 4980(a)(1)(B), neither the Traditional Plan nor the Combined Plan is a "qualified plan" with respect to which section 4980 applies. Accordingly, the excise tax under section 4980 does not apply to the reversion of the section 401(h) account assets to Taxpayer.

Since Taxpayer is a government instrumentality and is exempt from Federal income tax under section 115, Taxpayer's contributions to Trust A were not allowable as a deduction under section 419. Under section 4976(b)(3), section 4976(b)(1)(C) does not apply to any amount attributable to contributions to a fund that were not allowable as a deduction under section 419. Consequently, the transfer of Trust A's assets to Trust B upon Trust A's termination will not result in any "disqualified benefit" within the meaning of section 4976(b)(1)(C), and will not, in and of itself, cause Taxpayer to be liable for excise tax under section 4976.

RULINGS

1. The return of the section 401(h) account assets to Taxpayer will not result in a failure of the Traditional Plan or the Combined Plan to satisfy the requirements of section 401(h).
2. Taxpayer will not be subject to excise tax under section 4980 as a result of the return of the section 401(h) account assets to the Taxpayer; and
3. The transfer of assets from Trust A to Trust B upon termination of Trust A will not result in a "disqualified benefit" within the meaning of section 4976(b)(1)(C), and will not, in and of itself, cause Taxpayer to be liable for excise tax under section 4976.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based on the assumption that the Traditional Plan and the Combined Plan are qualified under section 401(a). These rulings are based upon information and representations submitted by Taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Specifically, it does not address the tax consequences of the transactions to participating employers or to Trust A or Trust B. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,



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