

Documenting Governmental Plan Investments in Group Trusts to Satisfy the Adoption Requirement in Revenue Ruling 81-100

Investment managers use group trusts to aggregate and invest assets of unrelated pension plans. Investment strategies can be broad, and can include domestic and foreign securities. While group trusts bring efficiencies of scale to pension investments, they also present legal hurdles for governmental plans because applicable tax rulings require the investor to "adopt" the terms of the group trust.

The legal underpinning for group trust investments is Revenue Ruling 81-100, as amended by Revenue Ruling 2004-67 and Revenue Ruling 2011-1.¹ These revenue rulings specify the requirements for a group trust to remain tax-exempt under the Internal Revenue Code (the Code).² The requirement that the investor "adopt" the group trust is the one that has given governmental investors the most consternation.

The group trust sponsor typically documents the investment by asking the governmental plan to "adopt" the group trust's governing document as a part of the governmental plan's "trust agreement and the plan under which it is administered." The Internal Revenue Service provides no guidance on how adoption must occur, but the basic rule is clear: tax advantages are only available so long as the group trust's investors adopt the group trust.

Two challenges commonly occur in connection with the adoption process. First, the group trusts are frequently designed for non-governmental tax-exempt investors, and the adoption agreement will reference items such as the investor's "trust agreement and the plan under which it is administered" (which governmental investors rarely have). Instead, governmental investors are typically established by statutes or regulations, and governed by a board of trustees (or, in some cases, by a sole trustee). Since governmental plans typically are not administered under trust agreements, they cannot agree to adopt the group trust pursuant to a trust agreement. To overcome this hurdle, group trusts may need to revise their adoption documents to allow the investor to adopt the group trust's governing documents as a part of the investor's "governing instruments or statutes." We have negotiated with group trusts that have agreed to make this

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modification to their adoption agreement in order to be accessible to governmental investors.

Second, there is uncertainty as to how a statutory entity, such as governmental pension plan, can "adopt" a group trust document. On its face, the "adoption" requirement suggests that the group trust agreement, with all of its terms and conditions, would be added to, and become an integral part of, the governmental investor's implementing statute and rules. The investor's objections are that (1) only the legislature or board of trustees is likely to be able to make such changes, and (2) even if it were possible to amend the plan documents and adopt the group trust, it might be overly intrusive for the terms of a single investment to be incorporated into the governing documents of the investor.

If read literally, this second obstacle would be difficult to surmount as revising the statutes or having the governing board revise the investor's governing documents is impractical. Fortunately, in our experience, group trust sponsors have been able to get comfortable even though the governmental investors are unable to affirmatively modify their governing legal documents (whether statute, enabling rules and regulations, or investment guidelines). Rather, group trust sponsors are frequently satisfied even if the governmental investor's subscription agreement confirms that the group trust's terms are adopted on a more limited scale; specifically, that it is "adopted" only "to the extent of the governmental plan's interest in the group trust as a collective trust vehicle and as required by applicable law." (In this context, "adopt" is the equivalent to signing a subscription agreement, as no governmental investor that we are aware of has taken additional steps to incorporate the group trust agreement into the investor's own governing documents.) This is the solution that works for most group trusts and also for most governmental investors.

¹Revenue Ruling 2004-67 allows the assets of qualified plans such as employer pension, profit-sharing or stock bonus plans (§ 401(a)), individual retirement accounts (IRAs) (§ 408(e)) and eligible governmental deferred compensation plans (§ 457) to be pooled in a group trust. Revenue Ruling 2011-1 expanded the types of plans that may invest in 81-100 group trusts, to include custodial accounts (§ 403(b)(7)), defined contribution programs maintained by church organizations (§ 403(b)(9)) and governmental retiree benefit plans (§ 401(a)(24)).

²The requirements include: (1) The group trust itself must be adopted as a part of each adopting group trust retiree benefit plan; (2) the group trust instrument must expressly limit participation to qualifying pension (and other) accounts; and



(3) each group trust retiree benefit plan that adopts the group trust must expressly provide in its governing document that it is impossible for any part of the corpus or income of the group trust retiree benefit plan to be used for, or diverted to, purposes other than for the exclusive benefit of the plan participants and their beneficiaries.

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