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3/19/76

Info on this bill was given  
to John Carlson & Thym Smith tonight.  
A "note to the Press" is being prepared  
and it is supposed to be put out  
while on the trip. I told them they  
should not wait till Monday.  
10m

**APPROVED**  
MAR 19 1976

3/19/76

THE WHITE HOUSE

ACTION

WASHINGTON

Last Day: March 20

March 18, 1976

MEMORANDUM FOR

THE PRESIDENT

FROM:

JIM CANNON

SUBJECT:

H.R. 11700 - Tax Status of 5 New York City Employee Pension Funds

Attached for your consideration is H.R. 11700, sponsored by Representative Rangel, which would permit 5 New York City employee pension funds to purchase municipal obligations without endangering the tax status of such funds.

A discussion of the provisions of the enrolled bill is provided in OMB's enrolled bill report at Tab A.

OMB, Treasury, Max Friedersdorf, Counsel's Office (Lazarus) Bill Seidman and I recommend approval of the enrolled bill.

RECOMMENDATION

That you sign H.R. 11700 at Tab B.

Posted  
3/20/76  
for Archives  
3/22/76



3-8-76

Mr. Linder:

Mr. Bruce Kirschenbaum of the Wash. Off. of Mayor Beame, N. Y. wishes to be notified as soon as the President signs H. R. 11700, the N. Y. C. Pension Bill.

Peg

---

3/19/76

Linder says he didn't call him. If the  
guy calls in tomorrow he will tell him  
Tom



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

MAR 15 1976

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 11700 - Tax status of 5 New York  
City employee pension funds  
Sponsor - Rep. Rangel (D) New York and 2 others

Last Day for Action

March 20, 1976 - Saturday

Purpose

To permit 5 New York City employee pension funds to purchase municipal obligations without endangering the tax status of such funds.

Agency Recommendations

Office of Management and Budget	Approval
Department of the Treasury	Approval

Discussion

Since March 1975, several measures have been taken by governmental bodies and private financial institutions to assist the City of New York through its severe financial crisis. One of these measures, an agreement to secure additional financing in order to carry out plans to achieve an orderly restructuring of the City's finances, was entered into on November 26, 1975. Signatories to that agreement included the Municipal Assistance Corporation for the City of New York (MAC), eleven New York commercial banks, 4 City sinking funds and 5 City employee pension funds. The agreement generally provided for the purchase and exchange of certain securities by the parties. The agreement had several conditions of which two were of major importance: (1) the provision prior to February 1, 1976 of \$2.3 billion in Federal assistance to remain available



through June 30, 1978 "for the seasonal financing needs of the City" and (2) the receipt of a favorable IRS ruling or the enactment of legislation to the effect that the purchase of \$2.53 billion in New York City bonds, which the 5 employee pension funds had pledged to do, did not adversely affect the tax qualified status of these pension funds. The first condition was met when you signed the New York City Seasonal Financing Act on December 9, 1975. The enrolled bill would meet the second condition by permitting the 5 City employee pension funds to fulfill their bonds purchase pledge without endangering their tax status.

H.R. 11700 would permit these bond purchases by the 5 pension funds without such actions being considered violations of the "prohibited transactions" rule of the Internal Revenue Code or violations of the code requirement that pension plans be for the exclusive benefit of employees and their beneficiaries. Without this legislation, employees participating in these pension plans could well be taxed currently on their vested benefits, could lose estate and gift tax exclusions, and would not be entitled to special treatment of lump-sum distributions. Transactions the pension funds could engage in without jeopardizing their existing tax status include:

- entering into and amending the agreement mentioned above;
- making elections and waivers under the agreement; (If disapproved by the Secretary of the Treasury, waivers and amendments which affect the tax status of the pension funds would not go into effect.)
- acquiring and holding obligations under the agreement; and
- performing other acts provided by the agreement.

In addition the 5 pension funds would be permitted to take into account the financial condition of the City in making investment decisions. The Secretary of the Treasury is to receive reports on the financial conditions of the pension funds and to transmit copies thereof to the House Ways and Means Committee and the Senate Finance Committee.

H.R. 11700 is necessary because, as the attached Treasury Department letter notes, "An administrative determination by the Internal Revenue Service with respect to the impact of all of the bond purchases upon the pension funds cannot be satisfactorily accomplished under current law."

The enrolled bill is narrowly drawn so as to avoid (1) problems in the administration of tax laws with regard to other employee pension funds, and (2) the establishment of an unfavorable precedent. The proposed legislation would have no revenue impact except to maintain the existing status of the 5 pension funds in question.

The effective date of the bill would be August 20, 1975.

*James M. Frey*  
Assistant Director  
for Legislative Reference

Enclosures



THE WHITE HOUSE

*3 X loop 1*

ACTION MEMORANDUM

WASHINGTON

LOG NO.:

Date: March 15

Time: 600pm

FOR ACTION: Bill Seidman *oh* cc (for information): Jack Marsh  
 Max Friedersdorf *oh* Jim Cavanaugh  
 Ken Lazarus *oh*  
 PBul Leach *oh*  
 Steve McConahey *oh*

FROM THE STAFF SECRETARY

DUE: Date: March 16

Time: 500pm

SUBJECT:

H.R. 11700 - Tax Status of 5 New York City  
 employee pension funds

ACTION REQUESTED:

- For Necessary Action
- For Your Recommendations
- Prepare Agenda and Brief
- Draft Reply
- For Your Comments
- Draft Remarks

REMARKS:

Please return to Judy Johnston, Ground Floor West Wing



PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

\_\_\_\_\_  
 K. R. COLE, JR.  
 For the President



To:   
 Judy Johnson   
 3-15-76



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

MAR 15 1976

MEMORANDUM FOR THE PRESIDENT

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Date: March 15

Time: 600pm

FOR ACTION: Bill Seidman  
Max Friedersdorf  
Ken Lazarus  
Paul Leach  
Steve McConahey

cc (for information): Jack Marsh  
Jim Cavanaugh  
Ed Schnulds

FROM THE STAFF SECRETARY

DUE: Date: March 16

Time: 500pm

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ACTION REQUESTED:

- For Necessary Action
- For Your Recommendations
- Prepare Agenda and Brief
- Draft Reply
- For Your Comments
- Draft Remarks

REMARKS:

Please return to Judy Johnston, Ground Floor West Wing

*Approve*  
*Logan B. Packer for A.W.S.*

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

James M. Cannon  
For the President

Date: March 15

Time: 600pm

FOR ACTION: Bill Seidman  
 Max. Friedersdorf  
 Ken Lazarus  
 Paul Leach  
 Steve McCahey

cc (for information): Jack Marsh  
 Jim Cavanaugh  
 Ed Schmults

FROM THE STAFF SECRETARY

DUE: Date: March 16

Time: 500pm

SUBJECT:

H.R. 11700 - Tax Status of 5 New York City  
 employee pension funds

## ACTION REQUESTED:

- |   |  |
|---|--|
| <input type="checkbox"/> For Necessary Action         | <input checked="" type="checkbox"/> For Your Recommendations |
| <input type="checkbox"/> Prepare Agenda and Brief     | <input type="checkbox"/> Draft Reply                         |
| <input checked="" type="checkbox"/> For Your Comments | <input type="checkbox"/> Draft Remarks                       |

## REMARKS:

Please return to Judy Johnston, Ground Floor West Wing

No objection -- Ken Lazarus 3/16/76

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

James M. Cannon  
 For the President

THE WHITE HOUSE

WASHINGTON

March 16, 1976

MEMORANDUM FOR: JIM CAVANAUGH  
FROM: MAX L. FRIEDERSDORF  
SUBJECT: H.R. 11700 - Tax Status of 5 New York City  
employee pension funds

The Office of Legislative Affairs concurs with the agencies  
that the subject bill be signed.

Attachments



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

MAR 09 1976

Dear Sir:

This is in response to your request for the views of the Treasury Department on H.R. 11700 (94th Congress, 2nd Session) entitled "An Act Relating to the application of certain provisions of the Internal Revenue Code of 1954 to specified transactions by certain public employee retirement systems created by the State of New York or any of its political subdivisions" (the "Act").

This Act is part of the overall program to render financial assistance to New York City. On December 9, 1975, the President signed the New York City Seasonal Financing Act of 1975, authorizing the Secretary of the Treasury to loan up to \$2.3 billion at any one time to the City of New York in order that the City might maintain its essential governmental services. The Seasonal Financing Act was enacted by Congress with the understanding that the Agreement dated November 26, 1975 between the Municipal Assistance Corporation, several of New York City's commercial banks, five New York City pension funds and the New York sinking funds would take effect. This Agreement, itself, was generally conditioned upon the enactment prior to February 1, 1976, of Federal legislation that "would provide, by way of guarantees or otherwise, for the seasonal financing needs of the City over the period from the effective date thereof through a date not earlier than June 30, 1978, in a maximum amount of not less than \$2,300,000,000 at any time outstanding."

As part of the New York City Agreement, the five pension funds which entered into the Agreement -- namely, the New York City Employees' Retirement System, the Board of Education Retirement System for the City of New York, the New York City Fire Department Pension Fund, the Teachers' Retirement System for the City of New York, and the New York City Police Pension Fund -- agreed to purchase New York City bonds in the principal amount of approximately \$2.5 billion through fiscal 1978.

on a scheduled basis. All of these purchases were conditioned upon receipt of a ruling from the Internal Revenue Service or upon Congressional enactment of legislation to the effect that the purchases would not constitute prohibited transactions or otherwise adversely affect the qualified status of the pension funds for purposes of the Internal Revenue Code of 1954.

If the pension funds were to lose their qualified status under the Internal Revenue Code simply by reason of the City bond purchases, the income earned by the funds might be subject to Federal income taxation and participants might be required to pay an immediate tax on current plan assets and contributions.

An administrative determination by the Internal Revenue Service with respect to the impact of all of the bond purchases upon the pension funds cannot be satisfactorily accomplished under current law. At best, an Internal Revenue Service ruling can deal only with narrow technical issues and a limited amount of bond purchases.

Therefore, the Act is needed to enable the pension funds to purchase City bonds pursuant to the Agreement without jeopardizing their tax qualified status. The Act is narrowly drawn to deal with the problem without causing problems in the administration of the tax laws with respect to other plans and without unnecessarily establishing an unfavorable precedent.

The Act applies only to action taken by the pension funds which were parties to the Agreement and provides that no fund will be deemed to have failed to satisfy the requirements of section 401(a) of the Internal Revenue Code nor will be considered to have engaged in a prohibited transaction described in section 503(b) of the Code merely because it acts pursuant to the Agreement or, before January 1, 1979, considers for purposes of making investments or after December 31, 1978, considers for purposes of deciding whether to retain investments held on December 31, 1978, the extent to which the investments will (1) maintain the ability of the City of New York to make future contributions to the fund and satisfy the City's future obligations to pay pension and retirement benefits, and (2) protect the source of funds to provide retirement benefits. For purposes of the legislation, the acquisition or holding of any bond

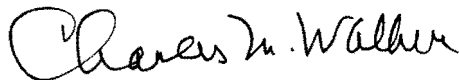
of the Municipal Assistance Corporation on or after August 20, 1975, and before November 26, 1975, will be deemed to have been acquired or held pursuant to the Agreement.

Moreover, the Act establishes reporting requirements and procedures with respect to the effectiveness of amendments to or waivers pursuant to the Agreement. No amendment to the Agreement having any bearing upon the qualified status of the pension funds and no waiver pursuant to the Agreement will take effect for purposes of the Act if the Secretary of the Treasury determines that the taking effect of such amendment or waiver is inconsistent with (1) maintaining the ability of the City to make future contributions to the funds and to satisfy the City's future obligations to pay pension and retirement benefits, and (2) protecting the source of funds to provide retirement benefits. Moreover, the trustees or administrators of each fund must furnish to the Secretary of the Treasury annual reports and such additional information as the Secretary may reasonably require. This information will then be furnished to the Chairman of the House Committee on Ways and Means and the Chairman of the Senate Finance Committee.

Given these important safeguards, the Treasury Department supports the Act as part of the overall program to render financial assistance to New York City.

The Act has no revenue impact, other than to preserve the normal tax attributes of a qualified pension plan.

Sincerely yours,



Charles M. Walker  
Assistant Secretary

Director, Office of Management and Budget  
Attention: Assistant Director for  
Legislative Reference, Legislative  
Reference Division  
Washington, D.C. 20503

RELATING TO TRANSACTIONS BY CERTAIN PUBLIC  
EMPLOYEE RETIREMENT SYSTEMS CREATED BY  
THE STATE OF NEW YORK OR ITS POLITICAL SUB-  
DIVISIONS

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FEBRUARY 25, 1976.—Committed to the Committee of the Whole House on the  
State of the Union and ordered to be printed.

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Mr. ULLMAN, from the Committee on Ways and Means,  
submitted the following

REPORT

[To accompany H.R. 11700]

The Committee on Ways and Means, to whom was referred the bill (H.R. 11700) relating to the application of certain provisions of the Internal Revenue Code of 1954 to specified transactions by certain public employee retirement systems created by the State of New York or any of its political subdivisions, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Page 2, strike out line 3 and all that follows down through line 14 on page 3, and insert:

such plan or trust does any or all of the following:

(1) (A) Enters into such agreement or agrees to an amendment of such agreement;

(B) forebears from any act prohibited by such agreement;

(C) acquires or holds any obligation the acquisition or holding of which is provided for by such agreement;

(D) makes any election provided for by such agreement;

(E) executes a waiver of any requirement of such agreement;

(F) after the expiration of such agreement, holds any obligation acquired or held pursuant to such agreement; or

(G) performs any other act provided for by such agreement;

(2) On or after August 20, 1975, and before January 1, 1979, considers, for purposes of determining investments



to be made by the plan or trust, the extent to which such investments will—

(A) maintain the ability of the city of New York—

(i) to make future contributions to the plan or trust, and

(ii) to satisfy its future obligations to pay pension and retirement benefits to members and beneficiaries of such plan or trust, and

(B) protect the sources of funds to provide retirement benefits for members and beneficiaries of the plan or trust; or

(3) After December 31, 1978, considers, for purposes of determining whether to retain investments held on December 31, 1978, the factors enumerated in paragraph (2).

For purposes of paragraph (1), the acquisition or holding of any obligation of the Municipal Assistance Corporation for the

Page 4, strike out line 3 and all that follows down through line 14 and insert in lieu thereof the following:

such amendment or waiver shall take effect for purposes of subsection (a) on the date on which a copy of such amendment or waiver is submitted directly to the Secretary of the Treasury; except that, if the Secretary determines, not later than 30 days after such date of submission (or, if later, the date of the enactment of this Act) that the taking effect of such amendment or waiver for purposes of subsection (a) is inconsistent with the considerations set forth in subsection (a)(2), such amendment or waiver shall not be deemed to have been effective for any period for purposes of subsection (a). No amendment to the agreement which has the effect of extending the expiration date of the agreement to a date later than December 31, 1978, shall take effect for purposes of subsection (a).

Page 4, strike out line 19 and all that follows down through the period in line 24 and insert:

beginning after June 30, 1975, and ending with the first fiscal year in which there are no obligations with respect to which subsection (a) applies, to the Secretary of the Treasury not later than 30 days after the date such report is filed with the New York State Insurance Department, and shall furnish such additional reports and other information as the Secretary of the Treasury may reasonably require.

### I. SUMMARY

This bill (H.R. 11700), as amended, will permit five New York City pension plans to purchase obligations of the City of New York and the Municipal Assistance Corporation (MAC) under an agreement worked out between these plans, 11 New York City banks, 4 New York City sinking funds, and MAC, without these actions being considered

violations of the prohibited transactions rules of the Internal Revenue Code or violations of the code requirement that the plans be for the exclusive benefit of employees and their beneficiaries. If these provisions were violated, the employees covered by the plans could well be taxed currently on their vested benefits, the employees could lose estate tax and gift tax exclusions, and they would not be entitled to special treatment of lump-sum distributions.

The bill in general will permit the plans to engage in the following transactions without endangering the tax status of the plans:

- (1) To enter into the agreement referred to above and to amend it;
- (2) to acquire and hold obligations under the agreement;
- (3) to make elections and waivers under the agreement; and
- (4) to perform other acts provided by the agreement.

Also, the bill will permit the plans to take the financial condition of the City into account in making investment decisions.

Amendments and waivers of provisions of the agreement which affect the tax status of the pension plans will not go into effect if disapproved by the Secretary of the Treasury.

Reports on the financial condition of the plans and other information will be furnished to the Secretary of the Treasury. He will furnish copies to the Ways and Means Committee and Finance Committee.

This bill is effective on and after August 20, 1975.

The committee considers this bill to be a part of the program of assistance provided by the Congress for New York City, and it is not intended as a precedent for any private pension plans or for other governmental pension plans being exempted from the exclusive benefit or the prohibited transaction rules of the tax law.

There is expected to be no revenue loss as a result of this legislation.

### II. BACKGROUND

Since March, 1975, a series of measures have been taken by the State of New York, City of New York, commercial banks, certain pension and sinking funds, and the Federal Government to allow the City of New York to achieve an orderly rationalization of its finances. In early April, the State provided an advance payment of \$400 million to the City for welfare payments due in June 1975. In May, the State advanced the City an additional \$400 million advance payment for welfare funds due in 1976. In June, however, it became apparent that the City would be unable to market its securities. The State created the Municipal Assistance Corporation for the City of New York (MAC) with the authority to use \$3 billion of its securities to finance the purchase of City notes. In the course of providing the City with a source of credit, MAC also rolled over much of the short-term obligations of the City into longer term MAC bonds with maturities of up to 15 years. MAC securities debt service payments are financed by receipts from the City's stock transfer and sales taxes. Also, MAC securities are backed by the "moral obligation" of the State.

In mid-July, 1975, MAC was experiencing difficulties in marketing its securities. Faced with almost certain default by the City, the State legislature passed the Financial Emergency Act which put together a \$2.3 billion financing package to meet the City's financing needs

through December, 1975. The legislation also created a seven-member Emergency Financial Control Board to administer the City's finances. The Board must adopt a three-year financial plan which moves the City toward a balanced budget by the end of the fiscal year (June 30) 1978. The Board must approve plans for decreasing the City's dependence on short-term borrowing to finance operating expenditures in the capital budget, for controlling growth in expenditures, and, if necessary, for freezing employee wages. In late October, 1975, the City presented to the Emergency Financial Control Board the three-year financial plan which was subsequently accepted.

By early November, 1975, it became apparent that Federal assistance would be a necessary ingredient to achieve a complete and orderly restructuring of the City's finances. Also, it became apparent that temporary relief from short-term debt payments would be necessary. On November 14, 1975 the State legislature passed the Emergency Moratorium Act for New York City which established a conditional three-year moratorium on enforcement of outstanding short-term obligations of the City. The moratorium became effective only for those holders of City notes who are first offered an opportunity to exchange their short-term obligations for long-term MAC bonds.

To secure additional financing, the Municipal Assistance Corporation for the City entered into an agreement on November 26, 1975, with 11 New York commercial banks<sup>1</sup> five pension funds,<sup>2</sup> and four sinking funds.<sup>3</sup> The agreement of November 26, 1975, generally provides for purchases and exchanges of certain securities under specified conditions, and was conditioned on direct Federal financial assistance.

The pension funds agreed to purchase \$2.53 billion of serial bonds of the City according to a schedule in the agreement and under certain conditions. In particular, these conditions include enactment by the State Legislature of legislation (which was enacted on December 4, 1975) which indemnifies the trustees and others from financial loss arising from any suit resulting from the purchase by the funds of the securities, or resulting from the sale of assets held by the funds to purchase the securities. Also, their participation is conditioned on a favorable ruling by the Internal Revenue Service, or the passage of legislation by the Congress, so that the purchases do not constitute prohibited transactions or otherwise adversely affect the tax-qualified status of the pension funds.

Participation of other parties to the agreement, most importantly the 11 commercial banks, is conditioned on participation of the pension funds.

In December the Congress also provided financial assistance to New York City. After discussions with the Administration, the Congress provided for direct Federal loans which would be repayable at the end of each year to smooth the normal seasonal fluctuations of the City's

<sup>1</sup> First National City Bank, Banker's Trust Company, U.S. Trust Company of New York, Chase Manhattan Bank Marine Midland Bank—New York National Bank of North America, Morgan Guaranty Trust Company, Irving Trust Company, The Bank of New York, Manufacturers Hanover Trust, and Chemical Bank.

<sup>2</sup> New York City Employees Retirement System, Board of Education Retirement System for the City of New York, New York City Fire Department Pension Fund—Article 1—B, Teacher's Retirement System for the City of New York, and the New York City Police Pension Fund—Article 2.

<sup>3</sup> Sinking Fund of the City of New York, Rapid Transit Sinking Fund of the City of New York, the Water Sinking Fund of the City of New York, and the Transit Unification Sinking Fund of the City of New York.

budget receipts in each fiscal year. These loans cannot exceed \$2.3 billion at any time. The bill, H.R. 10481 (Public Law 94-143), took effect December 9, 1975, and terminates June 30, 1978.

During December, the Internal Revenue Service twice provided restricted "letters of intent to rule" with respect to debt acquisitions by some of the New York City pension funds. Several of these New York City pension funds relied on these letters of intent to purchase New York City securities.

### III. PRESENT LAW REQUIREMENTS FOR STATE AND LOCAL GOVERNMENTAL PENSION PLANS

Present law generally provides qualified plans with substantial tax benefits. Employers, within certain limits, are permitted to deduct contributions made to these plans for covered employees' earnings on the plans' assets are exempt from tax, and covered employees defer payment of tax on employer contributions made on their behalf until they actually receive the benefits, generally after retirement when their incomes, and as a result, their applicable tax rates, tend to be lower. Also, special 10-year income averaging is allowed for lump-sum distributions, and certain estate tax and gift tax exclusions are provided. The employers, which are governments in the case in point in this legislation, are tax-exempt and therefore obtain no benefit from tax deductions or the special tax-exempt status accorded trusts under qualified plans.

However, the tax benefits for government employees are sufficient to encourage the adoption of qualified plans by governmental units. As a result, many governmental units have established retirement plans designed to qualify under the Internal Revenue Code.

Under the code (sec. 401(a)), a qualified plan must be for the exclusive benefit of employees and their beneficiaries.<sup>4</sup> A plan or trust which breaches the exclusive benefit rule of the code is disqualified. If a government plan is disqualified, the special tax treatment for employees under qualified plans is denied. In such a case, the employees would be taxed currently on the value of their vested benefits, the special estate and gift tax exclusions would not be available, and no special treatment would be accorded to lump-sum distributions.

Under the Internal Revenue Code certain sanctions also are applied where a trust engages in a "prohibited transaction". The Employee Retirement Income Security Act of 1974 (ERISA) tightened the prohibited transaction requirements, but these new requirements are not applied to governmental plans.<sup>5</sup> Therefore, the prohibited transactions of concern here are only those which were already in existence before ERISA was enacted.

Under the rules applicable to government plans, a pension trust which engages in a prohibited transaction loses its tax exemption (sec. 503(a)(1)(B)). For this purpose, a prohibited transaction is any transaction in which the trust lends any part of its income or

<sup>4</sup> Further, a trust does not qualify unless, under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of the employees or their beneficiaries. (Sec. 401(a)(2).)

<sup>5</sup> The comparable provisions of ERISA administered by the Department of Labor are similarly inapplicable to governmental plans (ERISA sec. 4(b)(1)).

corpus, without the receipt of adequate security or a reasonable rate of interest, to the creator of the trust, to a person who has made a substantial contribution to the trust, or to certain other persons. A trust may also breach the prohibited transaction rules, for example, if it makes any substantial purchase of securities or any other property for more than adequate consideration in money or money's worth from such a person or if it engages in any other transaction which results in a substantial diversion of its income or corpus to such a person (sec. 503(b)).

Generally, the Internal Revenue Service has treated a transaction which violates the prohibited transaction rules as a violation of the exclusive benefit rule. As indicated above, failure to meet the exclusive benefit rule also can cause the disqualification of the trust and the plan of which the trust is a part.

#### IV. REASONS FOR THE BILL

Your committee has found that several of the steps taken by the City of New York to remedy its financial condition involve City pension funds. Under present law, the ability of these funds to assist the City without endangering their qualified status depends on the application of the exclusive benefit and prohibited transaction rules. For example:

(1) Under the agreement of November 26, 1975, five New York City pension funds became obligated to retain certain securities of the City of New York and to purchase new debt of the City (and in some circumstances MAC). It may be argued that by entering into the agreement the funds violated the exclusive benefit rule.

(2) The funds may also be found in violation of the exclusive benefit rule if they retain City securities as required by the agreement of November 26, 1975, because it can be argued that this retention is not for the exclusive benefit of employees.

(3) The agreement of November 26, 1975, requires the funds to acquire New York City debt (and in some circumstances debt of MAC).<sup>6</sup> To acquire the debt pursuant to the agreement, your committee understands that the funds have been required to liquidate some of their investments under unfavorable market conditions. In addition, the liquidated investments may have been more advantageous to employees than the New York City or MAC debt. Under these circumstances, they may be violating the exclusive benefit rule.

(4) The New York City debt to be acquired by the funds is backed by the credit of the City. Questions may be raised as to whether the security for the debt is adequate in view of the City's present problems, especially since the Internal Revenue Service has taken the position that the pledge of an employer's general assets does not provide adequate security for purposes of the prohibited transaction rules.<sup>7</sup>

(5) In addition, funds available to pay off MAC bonds are limited to funds appropriated by the State of New York. At least two of the funds were created by the State of New York. If the MAC obligations

<sup>6</sup> Beginning August 20, 1975, the funds acquired MAC debt which, as of November 26, 1975, amounted to \$665 million.

<sup>7</sup> Rev. Rul. 70-131, 1970-1 C.B. 135. The ruling does not specifically refer to an employer which is a governmental unit.

are not backed by adequate security, their acquisition by these funds will violate the prohibited transaction rules.

In order to permit the trustees of the pension funds to take factors other than the exclusive benefit of employees into account in determining fund investments, on December 4, 1975, the State of New York adopted legislation permitting the trustees to take into account for investment purposes the extent to which investments will maintain the ability of the City of New York (1) to make future contributions to the retirement systems and funds, and (2) to satisfy the city's future obligations to pay pension and retirement benefits to members and beneficiaries of those systems and funds. The legislation also authorizes the trustees to take into account the extent to which the investments will protect the source of funds to provide retirement benefits for members and beneficiaries of the retirement systems and funds. If these factors are taken into account, New York State law (but not Federal law) in effect permits them to depart from the exclusive benefit rule.

Under the extraordinary circumstances involved here, your committee believes that it is necessary to allow the five New York City pension funds to participate in the effort to improve the financial condition of the City. Accordingly, your committee's bill permits these funds to carry out the provisions of the agreement of November 26, 1975, without being considered in violation of the exclusive benefit rule or the prohibited transition rules.

This approach is necessary in order to permit the implementation of the program of assistance provided by the Congress in December 1975, under Public Law 94-143. Your committee emphasizes that the bill is a part of that program and should not be considered as a policy decision that pension plans of private employers or other financially troubled governmental units will be exempted from the exclusive benefit rule or the prohibited transaction rules or a decision to expand the financial assistance provided for under Public Law 94-143 in any respect. The bill should not be regarded as a precedent to be cited by other governmental units which find themselves in financial distress.

#### V. GENERAL EXPLANATION

The bill provides that a pension plan or trust which, on December 5, 1975, was a party to the agreement of November 26, 1975 (and any trust forming a part of such a plan) will not be considered in violation of the exclusive benefit rule or the prohibited transaction rules of the code merely because it: (1) enters into the November 1975 agreement or agrees to an amendment to the agreement, (2) forbears from any act prohibited by that agreement, (3) acquires or holds any obligation the acquisition or holding of which is provided for by the agreement, (4) makes any election provided for by the agreement, (5) executes a waiver of any requirement of the agreement, or (6) performs any other act provided for by the agreement. In addition these plans or trusts can continue to hold any obligation acquired or held under the agreement after the expiration of the agreement. As a result, the bill will end uncertainty as to whether these acts (or forbearance) violate the exclusive benefit rule or the prohibited transaction rules.

Under the rule permitting the plans to acquire obligations if the acquisition is provided for by the agreement, the plans could, for exam-

ple, carry out the requirements of paragraph 3 of the November 1975, agreement. Under paragraph 3 of the agreement, when the moratorium period ends, City notes held by the plans during the moratorium may be (1) exchanged for short-term City notes, (2) renewed, or (3) used to purchase short-term City notes. The amount of City notes the plans are required to hold under this provision of the agreement is gradually reduced and phases out on July 1, 1986. In addition, the notes acquired by the plans through exchanges, etc. are to mature not later than July 1, 1986. If the moratorium period were to expire at the end of 1980, for example, exchanges, renewals, or purchases made thereafter (but before July 1, 1986) under paragraph 3 would be considered provided for by the agreement and would not cause the plans or trusts to violate the exclusive benefit or prohibited transaction rules.

Even with respect to transactions not provided for by the agreement, the requirements of present law as to the exclusive benefit rule and the prohibited transaction rules are set aside only to the extent these investments will maintain the ability of the City of New York to make future contributions to the plans and trusts and to satisfy its future obligations to pay pension and retirement benefits to members and beneficiaries of the plans and trusts. The bill also authorizes the trustees to take into account the extent to which the investments will protect the sources of funds to provide retirement benefits for members and beneficiaries of the plans and trusts. These factors, which correspond to the tests in the New York Act of December 4, 1975, require a balancing of the interests of the employees (and their beneficiaries) and the City.

The factors set out above may be taken into account during the period beginning August 20, 1975 (the date MAC obligations were first acquired by the trusts) and ending December 31, 1978. Also, the bill provides that the exclusive benefit rule and the prohibited transaction rules will not be violated if, after December 31, 1978, the trustees consider these factors for purposes of determining whether to retain investments held on December 31, 1978. Because the pension funds purchased MAC obligations before the date of the agreement, and these purchases were not provided for by the agreement, the bill additionally provides that acquisitions and holdings of MAC obligations on or after August 20, 1975, and before November 26, 1975, are to be considered acquisitions and holdings provided for by the agreement.

A transaction which is provided for by the agreement need not satisfy any other exemption provided by the bill. Similarly, an investment decision based on the special considerations involving the financial condition of the City need not be provided for by the agreement.

The bill provides special rules with respect to amendments of the agreement and waivers of requirements of the agreement. Under these provisions, if an amendment of the agreement relates to activity (or forbearance) described in the bill, and is relevant in determining whether the exclusive benefit rule or the prohibited transaction rules of the code are satisfied, for purposes of the bill the amendment is considered a part of the November 1975 agreement on the date it is submitted directly to the Secretary of the Treasury. However, if the Secretary (not including a delegate) determines, within 30 days after

the amendment or waiver is submitted to him (or, if later, within 30 days after the date of enactment of the bill) that the amendment or waiver is inconsistent with a balanced policy of protecting the security of employee benefits and improving the financial condition of the City of New York, for purposes of the bill, the amendment is not to be considered a part of the agreement at any time.<sup>8</sup>

These amendments must not be inconsistent with the policy of maintaining the ability of the City to make future contributions to the plans and trusts and to satisfy the City's future obligations to pay pension and retirement benefits to members and beneficiaries of the plans and trusts. Also, an amendment must not be inconsistent with the policy of protecting the sources of funds to provide retirement benefits for members and beneficiaries of the plans and trusts. These are the same factors which the plans and trusts may consider in making investment decisions. Similar rules would apply to waivers of requirements of the agreement. The fact that the bill does not recognize these amendments and waivers which are disapproved by the Secretary of the Treasury does not prevent them from being effective for other purposes. Of course, if the Secretary is not furnished sufficient information on which to make his determination on an amendment or waiver under these rules, it is expected that he will find the amendment or waiver inconsistent with the policy described above.

To limit the duration of the special rules provided by the bill, the bill provides that no amendment to the agreement which has the effect of extending the expiration date of the agreement to a date later than December 31, 1978, is to be recognized for purposes of the bill. An amendment of the agreement which imposes further obligations on the plans or trusts after December 31, 1978, would have the effect of extending the expiration date of the agreement and would not be considered a part of the agreement for purposes of the bill.

Also, the bill provides that the pension plans and trusts are to furnish to the Secretary of the Treasury a copy of their annual reports filed with the New York State Insurance Department for each fiscal year beginning after June 30, 1975, and ending with the first fiscal year in which there are no obligations with respect to which the exemption provided by the bill applies. These reports are to be filed with the Secretary of the Treasury not later than 30 days after the date the reports are filed with the New York State Insurance Department. In addition, the bill provides that the plans are to furnish the Secretary of the Treasury with such additional reports and information as he may reasonably require. The additional reports and information could be required at more frequent intervals than the reports to the Insurance Department. A copy of each report and information furnished to the Secretary of the Treasury is also to be furnished to the Chairman of the Committee on Ways and Means of the House of Representatives and the Chairman of the Committee on Finance of the Senate.

The bill is effective on and after August 20, 1975.

<sup>8</sup> If the date of the enactment of the bill is later than the date of submission, the 30-day period for the Secretary's determination begins on the date of the enactment of the bill.

## **VI. EFFECT ON THE REVENUES OF THE BILL AND VOTE OF THE COMMITTEE IN REPORTING THE BILL**

In compliance with clause 7 of rule XIII of the Rules of the House of Representatives, the following statement is made relative to the effect on the revenues of this bill. It is estimated that there will be no change in revenues as a result of this bill.

In compliance with clause 2(1)(2)(B) of rule XI of the Rules of the House of Representatives, the following statement is made relative to the vote by the committee on the motion to report the bill. The bill was ordered reported by a voice vote.

## **VII. OTHER MATTERS REQUIRED TO BE DISCUSSED UNDER HOUSE RULES**

In compliance with clauses 2(1)(3) and 2(1)(4) of rule XI of the Rules of the House of Representatives, the following statements are made.

With respect to subdivision (A) of clause 3 relating to oversight findings, it was as a result of your committee's oversight activity that it concluded that the financial situation of the City of New York, prior commitments of the five pension funds, and Federal interest in an orderly restructuring of the finances of the City of New York required the provisions of this bill.

In compliance with subdivision (B) of clause 3 of rule XI of the Rules of the House of Representatives, the committee states that the changes made to this bill involve no new budget authority.

With respect to subdivisions (C) and (D) of clause 3 of rule XI of the Rules of the House of Representatives, your committee advises that no estimate of comparison has been submitted to your committee by the Director of the Congressional Budget Office relative to the changes made by your committee, nor have any oversight findings or recommendations been submitted to your committee by the Committee on Government Operations.

In compliance with clause 2(1)(4) of rule XI of the Rules of the House of Representatives, your committee states that the inflation impact of the changes results from this bill should be negligible.

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives the committee states that no changes in existing law result from this bill.

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# Ninety-fourth Congress of the United States of America

AT THE SECOND SESSION

*Begun and held at the City of Washington on Monday, the nineteenth day of January,  
one thousand nine hundred and seventy-six*

## An Act

Relating to the application of certain provisions of the Internal Revenue Code of 1954 to specified transactions by certain public employee retirement systems created by the State of New York or any of its political subdivisions.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That (a) any pension plan or trust which, on December 5, 1975, was a party to the amended and restated agreement of November 26, 1975, set forth on pages S21308, S21309, and S21310 of the Congressional Record published on such date, and any trust forming a part of such a plan, shall not be considered to fail to satisfy the requirements of section 401(a) of the Internal Revenue Code of 1954, and shall not be considered to have engaged in a prohibited transaction described in section 503(b) of such Code, merely because such plan or trust does any or all of the following:

- (1) (A) enters into such agreement or agrees to an amendment of such agreement;
- (B) forebears from any act prohibited by such agreement;
- (C) acquires or holds any obligation the acquisition or holding of which is provided for by such agreement;
- (D) makes any election provided for by such agreement;
- (E) executes a waiver of any requirement of such agreement;
- (F) after the expiration of such agreement, holds any obligation acquired or held pursuant to such agreement; or
- (G) performs any other act provided for by such agreement;

(2) on or after August 20, 1975, and before January 1, 1979, considers, for purposes of determining investments to be made by the plan or trust, the extent to which such investments will—

(A) maintain the ability of the city of New York—

(i) to make future contributions to the plan or trust, and

(ii) to satisfy its future obligations to pay pension and retirement benefits to members and beneficiaries of such plan or trust, and

(B) protect the sources of funds to provide retirement benefits for members and beneficiaries of the plan or trust; or

(3) after December 31, 1978, considers, for purposes of determining whether to retain investments held on December 31, 1978, the factors enumerated in paragraph (2).

For purposes of paragraph (1), the acquisition or holding of any obligation of the Municipal Assistance Corporation for the city of New York on or after August 20, 1975, and before November 26, 1975, shall be considered an acquisition or holding provided for by such agreement.

(b) In the case of—

- (1) any amendment to the agreement described in subsection (a) which relates to the application of the factors set forth in subsection (a) to the requirements of section 401(a) or 503(b) of the Internal Revenue Code of 1954 and which is adopted after December 5, 1975, and

(2) any waiver of any requirement of the agreement by a plan or trust after December 5, 1975, such amendment or waiver shall take effect for purposes of subsection (a) on the date on which a copy of such amendment or waiver is submitted directly to the Secretary of the Treasury; except that, if the Secretary determines, not later than 30 days after such date of submission (or, if later, the date of the enactment of this Act) that the taking effect of such amendment or waiver for purposes of subsection (a) is inconsistent with the considerations set forth in subsection (a) (2), such amendment or waiver shall not be deemed to have been effective for any period for purposes of subsection (a). No amendment to the agreement which has the effect of extending the expiration date of the agreement to a date later than December 31, 1978, shall take effect for purposes of subsection (a).

(c) The trustees of each pension plan or trust described in subsection (a) shall furnish a copy of the annual report filed by such plan or trust with the New York State Insurance Department for each fiscal year of the plan or trust beginning after June 30, 1975, and ending with the first fiscal year in which there are no obligations with respect to which subsection (a) applies, to the Secretary of the Treasury not later than 30 days after the date such report is filed with the New York State Insurance Department, and shall furnish such additional reports and other information as the Secretary of the Treasury may reasonably require. A copy of each such report shall be furnished by the Secretary of the Treasury to the chairman of the Committee on Ways and Means of the House of Representatives and the chairman of the Committee on Finance of the Senate.

(d) The Secretary of the Treasury or his delegate is authorized to prescribe such regulations as may be necessary to carry out the purposes of this Act.

(e) This Act shall be effective on and after August 20, 1975.

*Speaker of the House of Representatives.*

*Vice President of the United States and  
President of the Senate.*