Church Plans under ERISA and the Internal Revenue Code

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This practice note describes the special status afforded to benefit plans sponsored by churches and certain church-related organizations under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (the Code). Such church plans are exempt from ERISA Titles I and IV and certain qualified retirement plan rules under the Code unless they make an affirmative election to be covered. In addition, several other Code provisions dealing with qualified and nonqualified deferred compensation plans apply special rules for certain church plans. Practitioners advising plan sponsors regarding church plan status eligibility, church plan elections, and special compliance considerations for church plans need to be familiar with these issues.

This practice note is organized as follows:

- Identifying Church Plans, Ruling Requests, and Curing Eligibility Failures
- Election to Be Subject to ERISA
- Qualified Plan Rules for Nonelecting Church Plans
- Other Church Plan Rules

Identifying Church Plans, Ruling Requests, and Curing Eligibility Failures

While the church plan exclusion under the Code for several provisions applicable to tax-qualified plans and ERISA have been there since the enactment of ERISA, it has only been in recent years that there has been a more intense focus on the parameters of the definition of church plan. This increased focus stems in large part because of the significantly underfunded status of defined benefit plans maintained by organizations such as hospitals that were characterized as church plans. Although some of these organizations clearly had an affiliation with a church, questions remained whether they or their delegees that were administering plans were established by a church or a church-controlled organization such that the plans qualified for church plan status. As discussed below under "Definition of Church Plan," a 2017 Supreme Court decision provided some clarity on this issue, but the Court left certain key definitional issues open.

Plan sponsors can request a determination of the status of their plans, primarily from the IRS, although the Pension Benefit Guaranty Corporation (PBGC) will also accept such requests. Plans that are intended to be church plans but fail to satisfy one or more church plan requirements have an opportunity within a limited specified period to correct and have their church plan status restored retroactively.

The subsections below discuss (1) key definitional points for determining church plan status, (2) agency ruling requests on church plan status, and (3) curing church plan status eligibility failures.

Definition of Church

A threshold question in analyzing church plans is to determine whether there is an entity that is or is sufficiently associated with a church. If an organization wants its plans to be treated as church plans for purposes of ERISA and the Internal Revenue Code, it must first establish that the organization qualifies as a church (or a convention or association of churches) that is exempt from federal taxation under I.R.C. § 501 or satisfies the principal purpose test as a church-associated entity (as discussed in the next section). The term church is not defined under either the Code or ERISA (except for an old Treasury regulation defining church in the context of unrelated business taxable income). However, Treasury regulations do provide that a church includes a religious order or religious organization if it is both an integral part of a church and carries out the functions of a church. Treas. Reg. §§ 1.414(e)-1(e) (definitions for retirement plan rules); 1.511-2(a)(3)(ii) (unrelated business income tax regulations, which expound further on the nature of the functional test as it relates to sacerdotal functions and conducting religious worship).

Courts and the IRS have proposed a series of tests to determine an organization's status as a church, with a goal of including newer, nontraditional religious organizations. Qualifying as a church is more difficult than qualifying as a religious organization exempt from federal income tax under Code Section 501(c)(3).

"[B]oth the courts and the Service agree that there is no bright line test as to whether an organization is a . . . church." I.R.S. Tech. Adv. Mem. 200437047. Several courts have acknowledged the possible First Amendment concerns that may arise when determining a taxpayer's qualification as a church. Found. of Human Understanding v. United States, 88 Fed. Cl. 203, 215 (Ct. Cl. 2009). In making the determination of church status, a court is not called upon to determine the "philosophical, theological, or ecclesiastical refinements" of the term church. Chapman v. Cmmr, 48 T.C. 358, 368 (1967). However, to provide some context, there is consensus that Congress intended the definition of church to be more restrictive than the term "religious organization." As a result, "[a]lthough every church may be a religious organization, not every religious organization is a church." Found. of Human Understanding v. Cmmr, 88 T.C. 1341 (1987).

There are at least four approaches that courts and the IRS have taken in attempting to define church:

Chapman Denomination Rule. The first approach, arising from the extensive legislative history discussion in the majority opinion in Chapman, defines the term church as synonymous with the concepts of denomination or sect. However, there is not strong support in the case law for this approach.

De LaSalle Common Meaning Approach. A second approach is set forth in De LaSalle Inst. v. United States, 195 F. Supp. 891, 898 (N.D. Cal. 1961). The district court concluded that in the absence of a Congressional definition of the term church, it is properly defined by the common meaning and usage of the word. While in general, in the absence of a statutory definition, a term is understood to have its plain meaning, courts have declined to follow this approach in this area. In American Guidance Foundation, Inc. v. United States, 490 F. Supp. 304 (D.D.C. 1980), the district court, in deciding not to follow the De La Salle approach, explained that a general or traditional understanding of the term church is elusive because there is no bright line beyond which certain organizational activities undertaken for religious purposes coalesce into a church structure, and the range of church structures extant in the United States is enormously diverse and confusing.

IRS 14 Factors. A third approach, adopted by the IRS in 1977, is the IRS 14 factor approach. See Gen. Couns. Mem. 36993, 1977 GCM LEXIS 185 (incorporated into Internal Revenue Manual 7.26.2.2.4). Courts find this test helpful, but do not necessarily adopt it. The 14 factors are:

- Distinct legal existence
- Recognized creed and form of worship
- Definite and distinct ecclesiastical government
- Formal code of doctrine and discipline
- Distinct religious history
- Membership not associated with any church or denomination
- Organization of ordained ministers
- Ordained ministers selected after completing prescribed studies
- A literature of its own
- Established places of worship
- Regular congregation
- Regular religious services
- Sunday schools for the religious instruction of the young –and–
- Schools for the preparation of its ministers

Each factor need not be satisfied to qualify as a church, other factors may be relevant, and some factors may have more weight than others in a particular case. Further, the IRS is aware that these factors need to be modified when applied to nontraditional churches. See I.R.S. Non-Docketed Service Advice Review 1407.

While no single characteristic is controlling, some courts treat certain of these 14 factors as core requirements, such as the existence of an established congregation served by an organized ministry, the provision of regular religious services and religious education for the young, and the dissemination of a doctrinal code.

Association Test. A fourth test is the associational test, also announced in the *American Guidance* decision. In that case, the district court stated that "at a minimum, a church includes a body of believers or communicants that assembles regularly in order to worship. Unless the organization is reasonably available to the public in its conduct of worship, its educational instruction, and its promulgation of doctrine, it cannot fulfill this associational role." American Guidance, 490 F. Supp. at 306.

While these may be regarded as four alternative tests to determine the status of an organization as a church, the IRS has on occasion required an organization to satisfy both the association test and at least a majority of the 14 factors. E.g., Priv. Ltr. Rul. 201221022.

In most instances, it will be clear whether a church is involved. One type of structure that does not qualify as a church is a one-person church, or a church consisting basically of family members and relatives. Also, although the Congressional use of the term church seems to derive from Christian tradition, it would obviously be constitutionally impermissible to read church to exclude Jewish, Islamic, or any other religious denomination's organizations.

Definition of Church Plan

Unless they make an election to be covered, church plans are exempt from Title I and Title IV of ERISA and from several provisions applicable to tax-qualified plans. ERISA §§ 4(b)(2), 4021(b)(3) (29 U.S.C. §§ 1003(b)(2), 1321(b)(3)); I.R.C. §§ 410(c)(1)(B), 411(e)(1)(B), 412(e)(2)(D). The definitions of church plan used for these exemptions are found at ERISA § 3(33) (29 U.S.C. § 1002(33)) and I.R.C. § 414(e). For traditional steeple churches, the analysis is straightforward. The arrangements that courts have struggled with are plans sponsored by organizations that clearly have some close ties with churches, but are large organizations such as hospitals whose plans are not established by churches. The analysis is complicated by the absence of definitions of critical terms such as principal-purpose organization.

The definition of church plan under ERISA and the Code are substantially identical. The difference is that the Code provides an additional subsection that provides special rules for chaplains and self-employed ministers. See I.R.C. § 414(e)(5). The statutes provide as follows:

- **Basic rule.** A church plan is a plan established and maintained for its employees (or their beneficiaries) by a church or a convention or association of churches which is exempt from taxation under I.R.C. § 501.
- **Excluded plans (participant tests).** A church plan does not include:
  - o A plan that is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses under I.R.C. § 513 (the UTB test) –or–
  - o A plan if less than substantially all of the participating individuals are either employees or deemed employees (as described below) of a church or convention or association of churches (or their beneficiaries) (the substantially all test)
- **Included plans (principal-purpose rule).** A church plan includes a plan maintained by an organization whose principal purpose or function is the administration or funding of a plan or program for the provision of benefits for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches for the provision of such benefits. For this purpose:
  - o An organization is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

The individuals who are deemed to be qualifying employees for purposes of the substantially all test are:

- Duly ordained, commissioned, or licensed ministers of the church in the exercise of their ministry, regardless of the source of their compensation
- Employees of an organization that (1) is exempt from tax under I.R.C. § 501 and (2) is controlled by or associated with a church or convention or association of churches
- Former employees of a relevant employer who continue to maintain benefits under a church plan, which individuals may be permitted to continue making contributions to the plan for up to five years (or indefinitely if they are disabled)

These deemed employee rules were added by Section 406 of the Multiemployer Pension Plan Amendments Act of 1980 (Pub. L. No. 96-364) to treat employees of organizations controlled by or associated with a church on the same basis as individuals employed directly by a church.

Thus, subject to satisfying the participant tests, a church plan may be:

- Sponsored (i.e., established and maintained) by a tax-exempt:

- o Church
- o Convention or association of churches –or–
- o Religious order or religious organization that is an integral part of and carries out the functions of a church (see Treas. Reg. § 1.414(e)-1(e)) –or–

- Maintained by an organization that is controlled by or associated with one of the foregoing entities and whose purpose is funding or administering plan benefits, pursuant to the principal-purpose rule

The following sections explain important elements of these definitions and tests. For purposes of those discussions, the term church is assumed to include any of the three types of eligible church-plan sponsors listed above, unless the context indicates otherwise.

Convention or Association of Churches

The term "convention or association of churches" has no clear legal meaning. The IRS has interpreted the concept in the context of charitable deductions as a "cooperative undertaking by churches of the same or differing denominations." Rev. Rul. 74-224; Priv. Ltr. Rul. 201309028 (following that Revenue Ruling to interpret I.R.C. § 414(e)). In contrast, the Court of Appeals for the Eighth Circuit took a different view, determining based on the legislative history that the same phrase in I.R.C. § 6033 derived from prior tax code usage pursuant to a request that the provisions be drafted in a way that would cover organizational structures used by "congregational" churches (e.g., Baptists, where each local congregation is autonomous) as well as "hierarchical" churches (e.g., the Catholic Church). Lutheran Social Serv. v. United States, 758 F. 2d 1283, 1288 (8th Cir. 1985).

Participant Tests

The two participant tests that look at the employees covered by a plan which must be satisfied for church plan eligibility are the unrelated trade or business (UTB) test and the substantially all test.

UTB Test

Unless a grandfathering rule applies (for plans in existence on September 2, 1974), a church plan must be both established and maintained primarily for the benefit of employees (or their beneficiaries) who are **not** employed in connection with one or more unrelated trades or businesses. Treas. Reg. § 1.414(e)-1(b).

An employee is treated as employed in connection with one or more unrelated trades or businesses of a church (a UTB employee) if a majority of their duties and responsibilities in the employ of the church are directly or indirectly related to the carrying on of the unrelated trades or businesses. Even if an employee's duties and responsibilities are insignificant with respect to any one unrelated trade or business, they will still be treated as a UTB employee if their duties with respect to all of the unrelated trades or businesses of the church represent a majority of the total of their duties and responsibilities in the employ of the church.

To pass the establishment prong of the UTB test, on the date the plan is established (if established after September 2, 1974), the number of employees employed in connection with an unrelated trade or business who are eligible to participate in the plan must be less than 50% of the total number of employees (and deemed employees) of the church eligible to participate in the plan.

A plan is considered maintained primarily for employees of the church for the UTB test if both of the following are true for four of its last five plan years: (1) less than 50% of the plan's participants were UTB employees and (2) less than 50% of the total compensation paid by the employer during the plan year was paid to UTB employees.

Even if a plan does not satisfy the above requirements, it can still be considered established and maintained primarily for the benefit of employees of the church if it can demonstrate this using a facts and circumstances test. Some of the factors to take into account in making this determination include the margin by which the plan failed the numerical tests and whether the failure was due to a reasonable mistake as to what constituted an unrelated trade or business.

Substantially All Test

To be a church plan, substantially all of the plan's covered employees must be employees of the church or in one of the categories of deemed employees described above. "Substantially all" is not defined for this purpose, although in other sections of the Code it means 85%, and in at least one church plan case, the parties agreed that 85% was sufficient. Medina v. Catholic Health Initiatives, 877 F.3d 1213, 1228 (10th Cir. 2017); see also Friend v. Ancilla Sys., 68 F. Supp. 2d 969, 973 (N.D. Ill. 1999) (finding six out of seven employees satisfied the substantially all test). It seems clear that it is acceptable for a de minimis number of employees included in the plan not to be church plan employees.

See "Organizations Controlled by or Associated with a Church" below for further discussion on eligible deemed employees.

Principal-Purpose Rule

Under the principal-purpose rule, a plan qualifies as a church plan if it is maintained by an organization whose principal purpose or function is the administration or funding of the plan if it is controlled by or is associated with (by sharing common religious bonds and convictions) a church for that purpose.

In Advocate Health Care Network v. Stapleton, 137 S. Ct. 1652 (2017), the Supreme Court, in an 8-0 decision (Justice Gorsuch not participating), held that a plan that is maintained by a principal-purpose organization that is controlled by or associated with a church can qualify as a church plan, even if it is not established by a church (reversing decisions in three circuit courts). However, the Supreme Court expressly declined to address the scope of the principal-purpose rule, such as what constitutes "maintaining" a plan, the requisite level of association with a church, or whether an internal benefits committee of a church-affiliated entity could qualify as a principal-purpose organization of the church.

In the same year as *Stapleton*, the Court of Appeals for the Tenth Circuit established a three-part test that must be satisfied by an entity seeking to establish church plan status under the principal-purpose rule:

- Is the entity whose employees are covered by the plan a tax-exempt church or a nonprofit organization controlled by or associated with a church?
- If the answer to the first question is yes, is the plan maintained by organization whose principal purpose is administering or funding a retirement plan for employees of or deemed to be employees of a church?
- If the answer to the second question is yes, is the principal-purpose organization itself associated with a church?

Medina v. Catholic Health Initiative, 877 F.3d 1213, 1222 (10th Cir. 2017).

With respect to the second question, a critical issue is what it means to maintain a plan. The Court of Appeals for the Eleventh Circuit had indicated that to maintain a plan, in the ordinary sense of the word, simply means to continue a plan. Anderson v. Unum Provident, 369 F.3d 1257, 1265 (11th Cir. 2004). In the context of that case, the court noted that if a company began to involve itself more in the payment of benefits, changed the critical terms of the policy, or performed all of the administrative functions associated with the maintenance of the plan, those actions would be maintaining the plan. In Medina, in the absence of a statutory definition, the court looked to Black's Law Dictionary and Webster's dictionary and concluded that the term simply means that the committee administering the plan "cares for the plan for purposes of operational productivity." Anderson, 369 F.3d at 1226. But this is not a universal view. By contrast, a California District Court opined, citing language in Stapleton, that "it is the entity maintaining the plan that has the primary responsibility (and potential liability) to plan participants." Rollins v. Dignity Health, 338 F. Supp. 3d 1025, 1036 (N.D. Cal. 2018).

See the following section for further discussion of organizations that can maintain a plan under the principal-purpose rule.

Organizations Controlled by or Associated with a Church

The controlled by or associated with test is important in two parts of the church plan definition. First, one of the categories of deemed church employees for purposes of the substantially all test includes individuals employed by an organization that is controlled by or associated with a church. Second, for the principal-purpose rule, the organization maintaining the plan must be controlled by or associated with a church.

Although ERISA does not define the phrase "controlled by," courts have interpreted the provision as referring to corporate control, such as church control over appointment of a majority of the non-church organization's officers or board of directors. Catholic Charities of Maine, Inc. v. City of Portland, 304 F. Supp. 2d 77, 85 (D. Me. 2004). This definition is also consistent with the IRS's interpretation of the phrase. Treas. Reg. § 1.414(e)-1(d)(2) (providing that "an organization, a majority of whose officers are appointed by a church's governing board or by officials of a church, is controlled by a church" for purposes of determining church plan status).

There is a split among the Circuit Courts of Appeal as to the meaning of "associated with." The Fourth and Eighth Circuits have proposed three nonexclusive factors: (1) whether the church plays any official role in the governance of the organization, (2) whether the church provides assistance to the organization, and (3) whether a denominational requirement exists for any employee or customer/client of the organization. Lown v. Continental Casualty Co., 238 F.3d 543 (4th Cir. 2001); Chronister v. Baptist Health, 442 F.3d 648 (8th Cir. 2006). The Tenth Circuit Court of Appeals rejected that approach as much narrower than the broad language of the ERISA definition. In its view, satisfying the *Lown* factors may suffice to establish that an organization is associated with a church, but an organization does not need to satisfy the *Lown* factors in order to be associated with a church. Medina, 877 F.3d at 1231.

The DOL has assessed the "religious bonds and convictions" phrase used in the definition to clarify the meaning of "associated" by looking at factors that assure the organization adheres to the tenets and teachings of the church, including whether the organization is listed in a religious directory and whether the church plays a part in the organization's governance. E.g., DOL, Adv. Op. 1991-10A; DOL Adv. Op. 1994-36A.

In determining whether an organization is associated with a church, the IRS has considered various factors, but church control, financial support, and, where applicable, listing in an official directory are significant factors.

The IRS has determined that an organization recognized in the Official Catholic Directory is considered associated with the Roman Catholic Church in the United States, and an employee of such organization is considered an employee of the Roman Catholic Church for purposes of the church plan exemption. Gen. Couns. Mem. 39007; see also Overall v. Ascension, 23 F. Supp. 3d 816, 831 (E.D. Mich. 2014).

Ruling Requests on Church Plan Status

IRS Private Letter Rulings

An organization seeking confirmation that its plan qualifies as a church plan can file a request for a private letter ruling with the IRS in accordance with general procedures updated annually for requesting private letter rulings. See Rev. Proc. 2020-1. The Revenue Procedure contains checklists to comply with the general procedures for all requests as well as specific requirements for church plan status determinations. The DOL generally defers to the IRS with respect to the status of a plan as a church plan. See, e.g., DOL, Adv. Op. 2004-11A.

Beginning in 2011, in light of increased litigation regarding underfunded defined benefit pension plans claiming exemption from ERISA's funding requirements and a concern that employees of these organizations were unaware of the implications of church plan status, the IRS requires applicants to notify plan participants of the request and allow them to submit comments to IRS, as described below.

Notice to Interested Parties for Church Plan Status Ruling

In 2011, the IRS provided supplemental procedures for requesting letter rulings under Code Section 414(e) relating to church plans. Rev. Proc. 2011-44. The generally applicable rules were modified to (1) require that plan participants and other interested parties receive notice regarding the letter ruling request, with a copy of the notice submitted to the IRS, and (2) permit the IRS to consider comments from interested persons. Interested persons mean each plan participant, beneficiary, or alternate payee, and any employee organization representing employees who are plan participants. If the plan is a multiemployer or multiple-employer plan, interested persons also include each contributing employer other than the party requesting the ruling.

The Revenue Procedure contains a model notice containing all of the information that must be provided to interested persons. The notice may include additional information, if that information is necessary or helpful to interested persons in understanding the required information. However, the additional information should not have the effect of misleading or misinforming recipients, or distracting recipients from the required information.

Mere posting of the information on a bulletin board is not sufficient to constitute a reasonable effort to satisfy the notice requirement, unless (1) the notice is prominently displayed on a bulletin board at a principal place of employment, (2) the bulletin board is regularly and actively used for a wide variety of purposes by employees who are plan participants, (3) the notice is given to all other interested persons by other methods that constitute a reasonable effort to satisfy the notice requirement, and (4) the notice provides that interested persons may request and receive a paper copy of the notice at no charge.

If an applicant makes a reasonable effort to satisfy the notice rules, the failure of one or more interested persons to receive the notice will not cause the applicant to fail the notice requirement.

Interested persons have 60 days to submit comments from the date the notice is provided, which must be within 30 days of the submission of the ruling request to the IRS. In addition to considering relevant written information, the IRS may permit interested persons to participate in the decision-making process by making oral presentations at meetings to which interested persons are invited.

It is solely within the discretion of the IRS as to whether or not to hold such meetings.

PBGC Coverage Determination

In July 2019, the PBGC finalized its streamlined coverage determination procedures for certain plans exempt from Title IV of ERISA. Its website now includes forms and instructions for these plans. While a determination by the PBGC is not required, plan sponsors would request this determination to confirm that they are not required to pay PBGC premiums. Although historically these requests were relatively rare, the new procedures may encourage more plans to seek these determinations. However, the PBGC has clarified that since it defers to the IRS in determining whether a plan is a church plan, it typically requires a plan to obtain a private letter ruling from IRS confirming its church plan status.

Retroactive Correction to Restore Church Plan Status

ERISA and the Code both permit an organization that was a church plan but subsequently fails to satisfy one or more of the church plan requirements to retroactively correct those failings within a limited period. ERISA § 3(33)(D) (29 U.S.C. § 1002(33)(D)); I.R.C. § 414(e)(4).

If timely cured, the plan is regarded as maintaining church plan status for the year in which the correction is made and for all prior periods. If the correction is not made within the correction period, the plan fails to be a church plan beginning with the date of the earliest failure to satisfy the requirements.

The correction period is the latest of:

- The period ending 270 days after a notice of default is sent regarding the plan's loss of status
- Any court-set period of correction after a determination that the plan fails to satisfy the requirements or, if the court fails to specify a period, any reasonable period determined by the Secretary of the Treasury that is not later than 270 days after the determination has become final
- Any additional period that the Secretary of the Treasury determines is reasonable or necessary to correct the default

Election to Be Subject to ERISA

A church or a church-related organization might wish to have some or all of its plans subject to ERISA to obtain the benefits of ERISA, such as preemption, elimination of the risk of being subject to punitive or consequential damages, and (so long as the plan so provides) application of a deferential arbitrary and capricious standard for judicial review of administrative determinations. In that circumstance, it can make an irrevocable election under I.R.C. § 410(d) for the plan to be subject to the Code and ERISA in the same manner as non-church plans. Thus, unless the plan makes an irrevocable Section 410(d) election, it will not be subject to the requirements of ERISA Title I or, for qualified retirement plans, certain Code sections establishing requirements regarding participation, vesting, funding, and other rules. I.R.C. § 410(d); ERISA § 4(b)(2) (29 U.S.C. § 1003(b)(2)). Similarly, a church plan that is a defined benefit pension plan is not subject to Title IV of ERISA unless it makes such an election and notifies the PBGC, although to date the PBGC has not provided any regulatory guidance as to how that notice should be provided. ERISA § 4021(b)(3) (29 U.S.C. § 1321(b)(3)).

There is some legislative history indicating that the election provision was added to the Code because Congress believed that employees covered under church plans would seek to pressure their employers to have the plans subject to ERISA.

Treasury Regulations clarify that a Section 410(d) election causes church plans to be subject to the following sections of the Code:

- Section 410 (minimum participation requirements)
- Section 411 (minimum vesting requirements)
- Section 412 (minimum funding requirements)
- Section 4975 (prohibited transactions) –and–
- Section 401(a)(11), (12), (13), (14), (15), (19), and (20) (relating to joint and survivor annuities, mergers and acquisitions, assignment and alienation of benefits, time of benefit commencement, certain Social Security increases, withdrawal of employee contributions, and total distributions)

Treas. Reg. § 1.410(d)-1(a).

Types of Plans Eligible for Making Election

The statutory structure is curious because Section 410(d) is part of a section dealing with requirements for tax-qualified defined benefit pension plans and money purchase pension plans. Based on that structure, the DOL took the position in Advisory Opinions 95-07A and 95-10A that the election did not apply to ERISA employee welfare benefit plans. However, district courts have to date been unpersuaded by the DOL's position. E.g., Rogers v. Ascension Health, Inc., 2018 U.S. Dist. LEXIS 227945, at *11–13 (N.D. Fla. 2018); Flynn v. Ascension Health Long Term Disability Plan, 787 F. Supp. 2d 1259, 1265 (E.D. Mo. 2014). The district court in Flynn also indicated in a footnote that the election could be made on a plan-by-plan basis.

There is no reference in Section 410(d) or implementing regulations to retroactive ERISA coverage. Thus, plan claims arising before a Section 410(d) election is made are not governed by ERISA, but claims arising after that date would be.

Making the Election

The irrevocable election to be subject to Title I of ERISA and these sections of the Code, which must be made by the plan administrator, is accomplished by attaching a statement to either the Form 5500 for the first plan year for which the election is to apply or to a written request for a favorable determination letter. If the election is made in connection with a request for a favorable determination letter, the election may be conditioned upon issuance of a favorable determination letter and will become irrevocable upon the issuance of such letter. The election statement must indicate that an election is being made under Code Section 410(d) and specify the first plan year for which the election will be effective. Treas. Reg. § 1.410(d)-1(c).

The IRS has concluded that an affirmative election consistent with the regulations is required and alternative means of electing coverage under ERISA may not be recognized. For example, the mere filing of a Form 5500 and the payment of PBGC premiums for a plan are not sufficient to constitute an election under Section 410(d). See Priv. Ltr. Rul. 201739010 and Priv. Ltr. Rul. 201826009.

Legislative Fixes for Nonelecting Church Plans

Church Plan Parity and Entanglement Prevention Act of 1999

ERISA § 514 (29 U.S.C. § 1144) addresses in detail the extent to which state insurance laws apply to insured and self-funded ERISA plans or are preempted, but does not address the state regulation of nonelecting church welfare plans, which are exempt from ERISA Title I. (For more information on this topic, see ERISA Preemption.) The Church Plan Parity and Entanglement Prevention Act (Pub. L. No. 106-244, codified at 29 U.S.C. § 1144) addressed that omission by clarifying what types of state laws can permissibly be applied to nonelecting church welfare plans.

Because church-sponsored welfare benefit plans are exempt from ERISA coverage absent an election under Section 410(d), there was uncertainty as to whether a state could deem a church's self-funded health plan to be an insurer for purposes of licensure, reserve requirements, and consumer protections. Pursuant to the Act, Congress clarified that an ERISA welfare plan that is a church plan (including a principal-purpose organization church plan) will not be treated as an insurer subject to state insurance regulation regarding licensing or solvency requirements.

The Act applies to any church plan that provides medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death, or unemployment or vacation benefits, apprenticeship or other training programs or day care centers, scholarship funds, or prepaid legal services. However, it excludes any entity that is a health insurance issuer, health maintenance organization, or any other organization that does business with the church plan or organization sponsoring or maintaining such a plan.

The plans covered by the Act are deemed to be sponsored by a single employer that reimburses costs from general church assets or purchases insurance coverage with general church assets or both.

States may enforce other types of insurance laws applicable to church plans as if the church were a licensed insurer. The Act expressly does not recharacterize the status, or modify or otherwise affect the rights, of any plan participant or beneficiary, which likely is intended to clarify that insurance laws providing consumer protections apply to church plans in accordance with their terms. For example, New York's Health Care Reform Act is applicable to church benefit plans.

Consolidated Appropriations Act, 2016

Many plan sponsors have found automatic enrollment to be useful in increasing participation in their 401(k) plans. The Consolidated Appropriations Act, 2016 (Pub. L. No. 114-113) removed an obstacle facilitating the ability of nonelecting church plans to do so.

Section 336(c) of the Act allows church plans to have an automatic contribution arrangement by superseding any state law relating to wage, salary or premium payment deduction, collection, garnishment assignment, or withholding that impedes the ability of a church plan to have an automatic enrollment feature.

While the automatic enrollment provisions of the Pension Protection Act of 2006 (Pub. L. No. 109-280) included such preemption language, it only applied to ERISA plans, thereby excluding church plans that have not made a Section 410(d) election. As a result, many nonelecting church plans were unable to adopt an automatic contribution arrangement because of state payroll deduction laws that are designed to protect employee wages from unauthorized payroll deduction and/or access by creditors. The Consolidated Appropriations Act provision equalized the availability of the automatic payroll feature for church retirement plans.

Qualified Plan Rules for Nonelecting Church Plans

The exemption from certain tax-qualified plan rules under the Code for church plans is more limited than the wholesale exclusion of church plans from Title I of ERISA. Thus, even nonelecting "exempt" church plans are subject to many of Qualified Plan Rules for Nonelecting Church Plans

Section 401(a) Requirements

The requirements of I.R.C. § 401(a) in the table below are generally applicable to nonelecting church plans, albeit with some modifications.

Code Section	Special Rules for Nonelecting Church Plans
401(a)(1)—contributions to the plan must be for employees	
401(a)(2)—exclusive benefit rule	
401(a)(4)—nondiscrimination rules 401(a)(5)—special nondiscrimination rules, including those related to salaried and clerical employees, permitted disparity, contributions and benefits that bear a uniform relationship to compensation, and plan aggregation rules	Regulations under I.R.C. §§ 401(a)(4), 401(a)(5) (and 401(l) and 414(s)) will not apply to nonelecting church plans until further notice and until such notice is provided, nonelecting church plans must be operated in accordance with a reasonable good faith interpretation of those statutory provisions. I.R.S. Notice 2001-46.
401(a)(8)—forfeitures in defined benefit plans	
401(a)(9)—minimum distribution requirements	The minimum distribution requirements for 5% owners do not apply to church plans, using definitions of church and qualified church-controlled organization as defined in I.R.C. § 3121(w)(3)(A), (B), providing that church means a church, a convention or association of churches, or an elementary or secondary school that is controlled, operated, or principally supported by a church or a convention or association of churches, and a qualified church-controlled organization means any church-controlled tax-exempt organization other than ones that (1) offer goods, services, or facilities for sale to the general public, except on an incidental basis or if sold at a nominal charge that is substantially less than the cost to provide them, and (2) normally receive more than 25% of their support from either government sources or receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in activities that are not unrelated trades or business, or both.
401(a)(10)(b) and 416—top heavy requirements	
401(a)(16) and 415—limitations on contributions and benefits	The I.R.C. § 415(b)(1)(B) compensation based limit that is generally applicable to defined benefit plans is not applicable to the plan of a church (as described in I.R.C. § 3121(w)(3)(A); see above) if the participant has never been a highly compensated employee (HCE). If they later become an HCE, the plan is not treated as violating the compensation based limit so long as no plan amendment adopted in the year the participant becomes an HCE increases the participant's benefits and there is no increase in the participant's accrued benefit derived from employer contributions in subsequent years. Treas. Reg. §§ 1.415(b)-1(a)(6)(iv), (a)(7)(iv).
401(a)(17)—limitation on compensation	
401(a)(25)—requiring actuarial assumptions be set forth in the plan	
401(a)26)—additional participation requirements	
401(a)(27)—determination as to profit sharing plan	
401(a)(30)—limitation on elective deferrals under Code Section 402(g)	
401(a)(31)—direct transfer of eligible rollover distributions	
401(a)(36)—in-service distributions permitted to individuals who have attained age 59½	
401(a)(37)—death benefits under USERRA	

Application of Pre-ERISA Requirements

Even though a nonelecting tax-qualified church plan is not subject to all of the Section 401(a) requirements, as described above, it continues to be subject to some pre-ERISA Code requirements as in effect on September 1, 1974, including nondiscrimination, vesting, participation and coverage, and prohibited transaction requirements.

Nondiscrimination and Vesting

Former Section 401(a)(4) stated that plan contributions or benefits must not discriminate in favor of employees who are "officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees." Former Section 401(a)(7) stated in pertinent part that upon a plan's termination or complete discontinuance of contributions, "the rights of all employees to benefits accrued to the date of such termination or discontinuance, to the extent funded, or the amounts credited to the employees' accounts are nonforfeitable."

Participation and Coverage

For pre-ERISA participation and coverage requirements, the relevant provisions were former Sections 401(a)(3) and 401(a)(5). The participation rule provided that the plan could satisfy one of two alternative percentage tests, either:

- 70% of all employees must be covered under the plan –or–
- 70% or more of all employees must be eligible under the plan and, if so, at least 80% of all eligible employees must be covered

These percentages are applied after excluding employees (1) who worked less than a period stated in the plan, not to exceed five years, (2) who customarily work fewer than 20 hours per week, and (3) whose customary employment is not more than five months in any calendar year. In lieu of these percentage tests, a plan could cover a classification of employees that does not discriminate in favor of officers, shareholders, persons whose principal duties consist of supervising the work of other employees, or highly compensated employees. This alternative test was commonly referred to as the fair cross section test.

The coverage requirements under former Section 401(a)(5) provided that a classification would not be considered discriminatory merely because it was limited to salaried or clerical employees. A church plan that satisfies the current Section 410(b) rules is deemed compliant. Treas. Reg. § 1.410(b)-2(e).

Prohibited Transaction Rules

A nonelecting church plan is exempt from the prohibited transaction rules under ERISA § 406 (29 U.S.C. § 1106) and I.R.C. § 4975, but is subject to pre-ERISA prohibited transaction rules, which remain in place under I.R.C. § 503.

Code Section 4975(g)(3) provides that the prohibited transaction rules of Section 4975 do not apply to a church plan if no Section 410(d) has been made. However, nonelecting church plans eligible for the Section 4975(g)(3) exemption remain subject to I.R.C. § 503, which provides that a church plan trust can lose its tax-exempt status if there is a prohibited transaction.

Section 503(b) listed six types of transactions that are prohibited if they involve the creator of a church plan or trust; a substantial contributor to the trust; a family member of the individual who created the trust or a substantial contributor; or a corporation controlled by such creator or person, through the direct or indirect ownership of 50% or more of either the total combined voting power of all classes of stock entitled to vote or of the total value of shares of all classes of the corporation. The six transactions are:

- Lending any part of its income or corpus without the receipt of adequate security and a reasonable rate of interest
- Paying any compensation in excess of a reasonable allowance for salary or services rendered
- Making any part of its services on a preferential basis
- Making any substantial purchase for more than adequate consideration
- Selling any part of its securities or other property for less than adequate consideration –and–
- Engaging in any other transaction which results in a substantial diversion of its income or corpus

Special Rules for Church Plans under the Code

Certain sections of the Code, such as Code Sections 79, 403(b), 415, and 457 have special rules as they apply to 401(a), 403(b), 457, and other types of church plans.

Controlled Group Rules

Controlled group rules were designed with for-profit entities in mind and needed to be modified for nonprofit entities that were not owned by individuals. As a subset of those rules, special controlled group rules apply to church plans.

Under I.R.C. § 414(c)(2), the general rule is that an organization that is eligible to participate in a church plan is not aggregated with another such organization for a plan year beginning in a tax year, unless:

- One of the other organizations provides, directly or indirectly, at least 80% of the operating funds for the other organization during the previous tax year of the recipient organization –and–
- There is a degree of common management or supervision between the organizations such that the organization providing the operating funds is directly involved in the day-to-day operations of the other organization

However, even if these criteria are met, the church (or convention or association of churches), or an organization designated thereby, may elect to treat the other participating organization as a distinct single employer for a plan year. This election, once made, must apply to all later plan years, unless revoked with notice provided to IRS.

In addition, an employer may elect to treat churches described in I.R.C. § 3121(w)(3)(A) (including church-controlled organizations described in I.R.C. § 3121(w)(3)(B)) separately from entities that are not churches as so defined, without regard to whether those entities maintain separate church plans. This election, once made, applies to all later tax years, unless revoked with notice to IRS.

Notwithstanding the general rule, certain so-called nonqualified church-controlled organizations and taxable entities related to such organizations must be aggregated. Specifically, a nonqualified church-controlled organization must be aggregated with one or more other nonqualified church-controlled organizations, or with an organization that is not tax exempt, and treated as a single employer for purposes of both 414(c) and (m), if at least 80% of the trustees or directors of the other organization are either representatives of, or directly or indirectly controlled by, the nonqualified church-controlled organization. For these purposes, a nonqualified church-controlled organization is a church-controlled tax-exempt organization that is not described in I.R.C. § 3121(w)(3)(B). In other words, a **nonqualified church-controlled organizations** is one for which either of the following is true: (1) it offers goods, services, or facilities for sale to the general public, except on an incidental basis or if sold at a nominal charge that is substantially less than the cost to provide them, or (2) it normally receives more than 25% of its support from either government sources or receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in activities that are not unrelated trades or business or both. Common examples include hospitals and universities controlled by a church.

The anti-abuse rules of Treasury Regulation § 1.414(c)-5(f) continue to apply for purposes of determining whether entities are under common control.

Multiple-Employer Status

While 2019 DOL regulations and the SECURE Act expanded the types of employers that could participate in a multiple-employer plan, each of the employers in a multiple-employer church plan must be a church.

To qualify as a multiple-employer church plan, (1) each of the employers must be a tax-exempt church and (2) the plan must satisfy the regulations relating to the establishment and maintenance of a plan primarily for persons not employed in connection with one or more unrelated trades or businesses (discussed above under "Definition of Church Plan—Participant Tests") as applied to the employees of each participating employer. If the plan fails to satisfy these two requirements, the entire plan ceases to be a church plan unless the ineligible employer ceases maintaining the plan for all plan years beginning after the plan year in which the employer received a final notification from the IRS that it failed to satisfy the requirements. However, if the employer ceases to participate in the plan, the fact that such employer previously did not properly maintain the plan does not prevent the plan from being a church plan for prior years. Treas. Reg. § 1.414(e)-1(c).

403(b) Church Plans

Special rules apply for churches (and qualified church-controlled organizations) that sponsor 403(b) plans. These primarily concern (1) an exemption from certain nondiscrimination requirements, (2) an employer payments to a retirement income account, (3) an annual addition limitation special rules, and (4) a special 15-year catch-up contribution rule. These rules are described in the following sections. For more information on this topic, see 403(b) Plan Design and Compliance.

The definitions of church and qualified church-controlled organization used for most 403(b) plan rules are the ones in I.R.C. § 3121(w)(3)(A) and (B), providing that a church means a church, a convention or association of churches, or an elementary or secondary school that is controlled, operated, or principally supported by a church or a convention or association of churches, and a qualified church-controlled organization means any church-controlled tax-exempt organization other than ones that (1) offer goods, services, or facilities for sale to the general public, except on an incidental basis or if sold at a nominal charge that is substantially less than the cost to provide them, and (2) normally receive more than 25% of their support from either government sources or receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in activities that are not unrelated trades or business, or both.

Nondiscrimination Rule Exemption

Generally, 403(b) plans must satisfy similar nondiscrimination requirements as under I.R.C. § 401(a)(4), (5), (17), and (26) and I.R.C. § 401(m). However, 403(b) church plans are exempt from these rules as well as the universal availability rule that generally applies to 403(b) plans. I.R.C. § 403(b)(1)(D).

Retirement Income Account Rules for 403(b) Church Plans

Section 403(b) church plans may use so-called retirement income accounts as an alternative to annuity contracts and mutual fund custodial accounts. Under Section 403(b)(9)(B), a "retirement income account" is a defined contribution program established or maintained by a church, or a convention or association of churches, including a principal-purpose organization, to provide benefits for employees. Notably, retirement income account assets may be commingled with the general assets of the plan sponsor, subject to the applicable separate accounting rules.

Implementing regulations specify that such retirement income accounts must maintain a separate accounting sufficient for it to be possible at all times to determine the account's interest in the underlying assets and to distinguish that interest from any interest that is not part of the account:

- Limit benefits only to gains and losses on those assets
- Be operated for the exclusive benefit of plan participants or their beneficiaries such that assets are not diverted for any other purpose (explicitly prohibiting loans or extensions of credit to the employer) –and–
- Be maintained pursuant to a written plan that clearly states or otherwise evidences in a similarly clear manner that the plan is intended to constitute a retirement income account

Treas. Reg. § 1.403(b)-9(a)(2).

A retirement income account may distribute benefits in a form that includes a life annuity if the amount of the distribution has an actuarial present value at the annuity starting date equal to the participant's accumulated benefit, based on reasonable actuarial assumptions, and the plan sponsor guarantees benefits in the event that a payment is due that exceeds the participant's accumulated benefit. Treas. Reg. § 1.403(b)-9(a)(5).

Trust assets held under a retirement income account and trust assets held under a custodial account may be invested in a group trust with assets held under a tax-qualified plan or an individual retirement plan, although not all group trusts permit church plans to participate. Any asset of a retirement income account that is owned or used by a participant or beneficiary is treated as having been distributed to the participant or beneficiary.

There had been uncertainty regarding whether employees of certain church-related organizations could be covered by a retirement income account. In its preapproved 403(b) plan guidance, the IRS took the position, contrary to assumptions by many practitioners, that employees of nonqualified church-controlled organizations (i.e., those not described in I.R.C. § 3121(w)(3)(B)) were ineligible. However, a provision of the Setting Every Community Up for Retirement Enhancement (SECURE) Act (Pub. L. No. 116-94, Div. O, § 111) addressed this uncertainty by clarifying that the following individuals or employees of certain church-related organizations (deemed employees under I.R.C. § 414(E)) may participate in Code Section 403(b)(9) retirement income accounts:

- Duly ordained, commissioned, or licensed ministers, regardless of the source of his or her compensation
- Employees of a tax-exempt organization that is controlled by or associated with a church or a convention or association of churches –and–
- Employees who are included in a church plan who then separate from the service of a church or a convention or association of churches, or employees of a tax-exempt organization that is controlled by or associated with a church or a convention or association of churches

I.R.C. § 403(b)(9)(B) (amended to incorporate the definition of employee in I.R.C. § 414(e)(3)(B)).

Special Annual Addition Limitation Rules for 403(b) Church Plans

Special I.R.C. § 415 annual addition limit rules apply to 403(b) church plans (and qualified church-controlled organization plans). Instead of being limited to the lesser of $40,000 or 100% of the individual's compensation in all cases, an annual addition of $10,000 for a 403(b) church plan (whether to an annuity contract, retirement income account, or both) does not violate Section 415, even if the individual's compensation level was less. However, there is an aggregate $40,000 limit for this rule per person. That is, the amount of the contribution in excess of what would otherwise be a Code Section 415 excess cannot exceed $40,000. I.R.C. § 415(c)(7); Treas. Reg. § 1.403(b)-9(b). See Treas. Reg. § 1.415(c)-1(d) for applicable regulations and examples illustrating the rules.

Example. A participant has compensation of $7,000 and the church makes a contribution of $10,000. If the employee's compensation remained constant at $7,000 and the church contributed $10,000 each year, the practice could continue for 13 years, at which time the excess would be $39,000 or 13 times $3,000. In year 14, instead of contributing $10,000, the maximum permissible contribution would be $8,000 because the maximum excess can only include an additional $10,000.

For foreign missionaries, instead of the special allowable threshold limit being $10,000, it is $3,000, and the special rule is only available if the individual's adjusted gross income for the year (determined separately and without regard to community property) does not exceed $17,000. I.R.C. § 415(c)(7)(C); Treas. Reg. § 1.415(c)-1(d)(3).

Special 15-Year Catch-Up Election Rules for 403(b) Church Plans

The special catch-up election available for 403(b) plans allows participants who have worked for an employer for 15 or more years to contribute an additional amount up to $3,000 per year so long as their average annual contribution is less than $5,000, up to a maximum of $15,000. Administration of the 15-year rule is complex and has been discontinued by several nonprofit organizations. However, for those church plans that do offer the election, special eligibility rules apply.

For purposes of determining eligibility for the 15-year rule, all entities that are in a church-related organization or an organization controlled by a church-related organization are treated as a single entity. Thus, years of service with (and any previous 15-year rule catch-up contributions made to a plan of) any member of such a group is taken into account with respect to any other member of the group. Treas. Reg. § 1.403(b)-4(c)(3)(ii)(B). For this purpose, a church-related organization is a church, a convention or association of churches, or a principal-purpose organization associated with a church or convention or association of churches (as described in the Section 414(e) definition). Treas. Reg. § 1.403(b)-2(b)(6).

Special Years-of-Service Rules for 403(b) Church Plans

Years-of-service rules for 403(b) church plans provide that a participant will be credited not only with service for the church-related organization participating in the plan, but also any other eligible employer that is a church-related organization that has an association (within the meaning of I.R.C. § 414(e)(3)(D)) with the participating employer. However, service during any period in which the individual is not employed by a church-related organization or a church-related organization that does not have an association with an eligible employer is disregarded. Treas. Reg. § 1.403(b)-4(e)(3)(ii). See the previous section for the definition of church-related organization.

Section 457 Eligible Employers

Code Section 457 sets forth certain rules for the treatment of deferred compensation paid by so-called eligible employers, including governmental and most tax-exempt organizations. Eligible employers can establish a Section 457(b) "eligible deferred compensation plan," under which a participant's account balance will not be taxed until it is paid or made available, even if the participant vests in the amount before that time. These rules, however, do not apply for churches or qualified church-controlled organizations (as defined in I.R.C. § 3121(w)(3)(A) and (B)), as they are carved out of the definition of eligible employer. I.R.C. § 457(e)(13). Therefore, among church-related tax-exempt entities, only so-called nonqualified church-controlled organizations are subject to these deferred compensation rules.

The Section 3121 definitions provide that a church means a church, a convention or association of churches, or an elementary or secondary school that is controlled, operated, or principally supported by a church or a convention or association of churches, and a qualified church-controlled organization means any church-controlled tax-exempt organization other than ones that (1) offer goods, services, or facilities for sale to the general public, except on an incidental basis or if sold at a nominal charge that is substantially less than the cost to provide them, and (2) normally receive more than 25% of their support from either government sources or receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in activities that are not unrelated trades or business, or both.

Section 79 Group Term Insurance

While the special nondiscrimination rules of I.R.C. § 79 with respect to group term insurance generally do not apply to church plans, there is an exception for certain church plan sponsors.

The nondiscrimination requirements of Section 79 relating to group term life insurance do not apply to church plans (as defined in I.R.C. § 414(e)). However, for purposes of determining church plan employees, individuals employed by the following types of organizations are excluded:

- A school above the secondary school level, other than a school for religious training –or–
- An organization whose principal purpose or function is providing hospital or medical care, medical education, or medical research or any other Section 501(c)(3) organization whose basis for tax exemption is substantially similar to the foregoing

I.R.C. § 79(d)(7)(B)(ii).

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Barry Salkin concentrates his practice in ERISA and employee benefits law. He has significant expertise drafting, amending and negotiating various ERISA and employee benefit plans, including defined benefit pension plans, profit-sharing plans, 401(k) plans, as well as qualified and non-qualified deferred compensation programs. He also has wide-ranging experience crafting group medical and health plans involving Health Care Reform, HIPAA, and COBRA. In addition, he has represented clients in ERISA litigation and audits.

His clients include multi-national corporations, closely-held companies, high-net-worth individuals, financial institutions, governmental agencies, investment groups, and tax-exempt organizations such as hospitals and physicians' organizations.

Barry also advises clients on all aspects of retirement plan tax-qualification requirements and the application of labor and securities laws and regulations to sponsors of employee benefit plans and executive compensation programs. Moreover, he has extensive experience in establishing, merging and terminating benefit plans and compensation agreements, and counsels clients on fiduciary responsibilities and prohibited transactions.