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Pension Advocates Raise Questions About IRS Rulings on Church Plan Status

In the months since the Internal Revenue Service lifted a moratorium in 2011 on issuing private letter rulings on church plans, IRS has issued at least 13 rulings granting church plan status, including one conferring church plan status on a defined benefit pension plan sponsored by a tax-exempt 501(c)(3) unincorporated religious organization that had been paying pension insurance premiums to the Pension Benefit Guaranty Corporation since Jan. 1, 1974, practitioners said in interviews with BNA in June and July.

IRS determined that the plans covered by those recent rulings met the definition under tax code Section 414(e)(3)(A) for ''plans to be treated as church plans,'' said Karen Ferguson, director of the Pension Rights Center in Washington.

Some plans treated as church plans may be facing legal challenges, however. Five recent complaints filed by plaintiffs seeking class actions to challenge the church plan status of underfunded pension plans maintained by church-affiliated hospitals and health systems could signal a new wave of class actions brought under the Employee Retirement Income Security Act, according to David E. Rogers, a partner at McDermott Will & Emery in Washington (132 PBD, 7/10/13; 40 BPR 1702, 7/16/13).

Ferguson said the language of ERISA and related tax code provisions makes clear that Congress provided ERISA protections for all private-sector workers, ''with one narrow exception for church plans.'' She added that ''the legislative history makes plain that Congress enacted the church plan exemption only because it did not think that it was appropriate for a federal government agency, the Pension Benefit Guaranty Corporation, to examine a church's financial records.''

Others, however, have said that the statutory language defining a church plan under Section 414(e) is not black and white. ''It's clearly a gray area,'' said James J. Keightley, a partner at Keightley & Ashner in Washington. Congress always is ''dancing a fine line'' to avoid becoming involved in church matters, he said.

Treated as Church Plans Since June 2012, IRS has issued private letter rulings granting church plan status to at least five defined benefit plans, including a plan sponsored by a tax-exempt 501(c)(3) unincorporated religious organization on behalf of 48 parishes, 24 elementary and secondary schools, and 26 other agencies and institutions.

In PLR 201247023, IRS determined that the employer's pension plan met the definition of a church plan under Section 414(e) and that the plan had not made ''an irrevocable election'' under tax code Section 410(d) to be subject to Title I of ERISA (227 PBD, 11/28/12; 39 BPR 2287, 12/4/12). The taxpayer seeking the ruling described the plan as having operated ''voluntarily'' according to ERISA standards and regulations before seeking the ruling on church plan status.

''That's pretty incredible,'' said attorney and pension rights advocate Norman P. Stein, professor of law at Drexel University's Earle Mack School of Law in Philadelphia. ''If you're a church plan, you're not eligible for PBGC coverage. Why would you voluntarily pay premiums for insurance that you are not entitled to own?'' he said.

The facts in PLR 201247023 indicated that the pension plan's administrator had been filing Form 5500 annual reports, paying PBGC premiums, and regularly updating and amending the plan documents as required under ERISA and the tax code.

Many of the plans now applying for rulings operated since 1974 as ERISA plans, paid PBGC premiums, and received IRS approval of all amendments, Ferguson said. ''These are the plans we are concerned about. The participants in these plans earned guaranteed benefits, which they could lose as a result of these rulings,'' she said.

Rev. Proc. 2011-44. In all 13 recent rulings, the requests for church plan status were granted to employers that represented themselves as complying with Revenue Procedure 2011-44 (184 PBD, 9/22/11; 38 BPR 1743, 9/27/11). The 2011 revenue procedure and model notice, whose issuance ended a five-year moratorium on church plan rulings, requires employers to notify plan participants and other interested persons of a decision to seek church plan status and to explain the consequences it could have for participants if it meant losing protections provided under ERISA.

The notification requirement ''lets people know they're getting the rug pulled out from under them,'' Keightley said.

Rev. Proc. 2011-44 also gives participants and other interested persons an opportunity, within 60 days of receiving the employer notice, to ask IRS to consider written and oral comments related to the employer's request for church plan status.

Ferguson said the Pension Rights Center has been working with pension plan participants who have been notified of their employer's pending request for church plan status and have filed comments. In one instance, involving a Maryland social services organization, par-

ticipants were able to persuade the employer to withdraw the ruling request, Ferguson said.

Types of Plans. According to Ferguson, the Pension Rights Center takes the position that, based on ERISA and related tax code provisions, there are only two types of church plans: (1) plans established and maintained by a church and (2) plans maintained by a church pension board.

Other types of plans that claim church status fall outside the narrow exemption that Congress crafted in 1974 and amended in 1980, Ferguson said. Those, she said, include defined benefit pension plans established by nonprofit hospitals, social services agencies, and educational organizations that are affiliated with, but not backed by, a church.

''This third category is based entirely on the IRS rulings and has no support in the language of the statute or its legislative history,'' Ferguson said. In its rulings, IRS has conferred church plan status on plans established by organizations associated with a church and administered by an internal retirement committee, she said.

A retirement committee does not ''maintain'' a plan, and it is not ''an organization, whether a civil law corporation or otherwise,'' as described in Section 414(e)(3)(A), Ferguson said. ''We're pretty sure that the 'or otherwise' language in the statute was just shorthand for 'nonprofit association or trust,' which were the other forms that church pension boards took'' when ERISA was amended in 1980 to expand the definition of church plan, she said.

The 1980 amendments applied retroactively to 1974, she said. But from 1974 to 1980, plans were not complying ''voluntarily'' with the law, Ferguson said. Under ERISA, as originally enacted in 1974, all plans that were not established directly by churches for their own employees, with the exception of church pension board plans that were under a temporary exemption until 1982, were required to comply with ERISA beginning Jan. 1, 1974, Ferguson said.

ERISA History. Under ERISA, as enacted in 1974, a church plan had to be sponsored by a church and could not cover employees of church-affiliated institutions, Stein said. ''A grandfather rule permitted existing plans to continue to cover such employees until 1982, after which the plan could only include employees of the church itself,'' he said.

However, some large denominational church groups went to Congress and complained, arguing that, if a church has a pension plan, the pension plan should be allowed to cover employees of organizations affiliated with the church, Stein said.

''So Congress in 1980 amended ERISA to say that churches that have pension plans, if they wanted to, were permitted to cover employees in organizations affiliated with the church. Congress did not say church-affiliated organizations were eligible to sponsor church pension plans,'' Stein said.

The large denominational church groups also wanted Congress to amend ERISA by expanding the 1974 definition of a church plan, which was ''a plan established and maintained by a church,'' to include plans maintained by pension boards that some large denominational church groups had appointed to maintain their pension plans, Stein said.

In 1980, ''Congress said, 'OK, we'll do that, too,' '' Stein said.

''Most, if not all,'' of those church pension boards operated on a national scale and were ''real organizations,'' not internal pension administration committees, Stein said.

''There was no doubt that a plan maintained by one of these church pension boards was still a pension plan, even though it was not maintained by the church itself, and that is how [the language] 'maintained by an organization, whether a civil law corporation or otherwise,' found its way into the tax code,'' Stein said.

However, IRS for 30 years interpreted those words ''erroneously'' to include hundreds of pension committees or, in some cases, affiliated organizations, provided they had ''some kind of relationship or tie of any sort to the church,'' he said.

Committees and affiliated organizations, however, are not organizations that ''maintain'' a plan, Stein said. The statute also requires that plans be established by a church, even though they are maintained by an affiliated organization, he said.

In rulings that IRS has issued since the agency lifted its moratorium on church plan rulings, IRS does appear to be ''looking for a closer tie'' between the church and the pension committee running the plan than it did previously, Stein said. However, the rulings still seem to distort the statute, he said.

''One would hope that the IRS would take a fresh look at the language of the statute and at least recognize that any plan that has told its employees for 40 years that the plan is protected by ERISA and has PBGC coverage has elected to be covered by ERISA,'' Stein said.

Earlier Ruling Reversed. A 10-year effort led by two former employees of a New Jersey community hospital to revoke an IRS church plan ruling ended successfully earlier this year (92 PBD, 5/13/13; 40 BPR 1154, 5/14/13).

The Pension Rights Center announced in March that IRS had revoked a 2003 private letter ruling that had recognized the pension plan operated by the community Hospital Center at Orange, N.J., as a church plan.

''The IRS should have never granted the HCO plan church plan status in the first place, and we are relieved that the agency has rescinded its decision,'' Ferguson said. PBGC played a critical role in the outcome of the HCO case, she said.

In May, PBGC announced it would cover the plan's $30 million shortfall and pay the pension benefits of the more than 800 former employees of the hospital center, which closed in 2004.

Increased Plaintiffs' Litigation Recent church plan cases involving plaintiffs seeking class certification are most likely the beginning of a new wave of lawsuits challenging underfunded church pension plans, David E. Rogers, a partner at McDermott Will & Emery in Washington, said during a July 9 webinar sponsored by the law firm. ''All significant religious hospital groups and other nonprofits could be targets for similar lawsuits,'' Rogers said.

He said the complaints are an attempt to overturn ''a well-settled IRS ruling position on church plan status'' by challenging the church plan status of underfunded pension plans sponsored by church-affiliated hospitals and health systems.

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''Church plans are exempt from most of the provisions of ERISA and are generally not structured or administered to comply with those provisions of ERISA,'' Rogers said. ''If ERISA were to apply,'' he said, ''these and potentially other church plans would have to increase their funded status and would have to comply with ERISA in many other aspects, including the payment of PBGC premiums.''

The five recent church plan cases are:

■ *Overall v. Ascension Health*, E.D. Mich., No. 2:13-cv-11396-AC-LJM, *complaint filed* 3/28/13 (62 PBD, 4/1/13; 40 BPR 831, 4/2/13; http://www.bloomberglaw.com/public/document/Overall_v_Ascension_Health_et_al_Docket_No_213cv11396_ED_Mich_Mar);

■ *Chavies v. Catholic Health East*, E.D. Pa., No. 2:13-cv-01645-CDJ, *complaint filed* 3/28/13 (62 PBD, 4/1/13; 40 BPR 831, 4/2/13; http://www.bloomberglaw.com/public/document/CHAVIES_et_al_v_CATHOLIC_HEALTH_EAST_et_al_Docket_No_213cv01645_E);

■ *Medina v. Catholic Health Initiatives*, D. Colo., No. 1:13-cv-01249, *complaint filed* 5/10/13 (http://www.bloomberglaw.com/public/document/Medina_v_Catholic_Health_Initiatives_et_al_Docket_No_113cv01249_D);

■ *Kaplan v. Saint Peter's Healthcare System*, D.N.J., No. 3:13-cv-02941, *complaint filed* 5/7/13 (http://www.bloomberglaw.com/public/document/KAPLAN_v_SAINT_PETERS_HEALTHCARE_SYSTEM_et_al_Docket_No_313cv0294); and

■ *Rollins v. Dignity Health*, N.D. Cal., No. 3:13-cv-01450, *complaint filed* 4/1/13 (http://www.bloomberglaw.com/public/document/Rollins_v_Dignity_Health_et_al_Docket_No_313cv01450_ND_Cal_Apr_01).

A private letter ruling is not required for church plan status, said Joseph K. Urwitz, an associate at McDermott Will & Emery in Boston, who also spoke during the webinar. Urwitz added, however, that a private letter ruling finding that a plan was a church plan ''might help a church plan sponsor defend against lawsuits challenging that status.''

BY FLORENCE OLSEN

The PLRs involving church plans are PLR 201222052, PLR 201224042, PLR 201230031, PLR 201233027, PLR 201247023, PLR 201302045, PLR 201303024, PLR 201308033, PLR 201309028, PLR 201318030, PLR 201319036,PLR 201322051, and PLR 201323043.