Church Retirement Plans

TARA SCHULSTAD SCISCOE, ICE MILLER LLP,
WITH PRACTICAL LAW EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION

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This Practice Note provides an overview of church retirement plans. It provides a general description of church plan status, notes issues affecting church retirement plans, and discusses special rules applicable to these plans under the Internal Revenue Code (Code) and the Employee Retirement Income Security Act of 1974 (ERISA).

Retirement and welfare plans established by churches or church-related organizations may qualify as "church plans" under the Internal Revenue Code (Code) and the Employee Retirement Income Security Act of 1974 (ERISA). Church plans are generally not subject to ERISA, including its rules relating to funding, vesting, reporting and disclosure, and fiduciary responsibility. As a result, church plans are exempt from providing certain notices, including:

- Form 5500s.
- Summary annual reports (SARs).
- Summary plan descriptions (SPDs).
- Summaries of material modifications (SMMs).

However, because church plans do not have the benefit of ERISA preemption, they are subject to state law. Defined benefit church plans are not subject to Pension Benefit Guaranty Corporation (PBGC) plan termination insurance nor are they required to pay PBGC premiums. Church plans are also exempt from many of the Code and other legal requirements that apply to the retirement and welfare benefit programs of other tax-exempt employers. Church plan status, therefore, has important implications that directly affect plan sponsor obligations and participant rights.

This Practice Note provides an overview of church retirement plans and discusses:

- The requirements for qualifying as a church plan.
- The types of church retirement plans.
- Special rules that apply to church plans under the Code and ERISA.

This Note focuses on church retirement plans. For information on church health and welfare plans, see Practice Note, Church Plans: Health and Welfare Plan Compliance and Litigation (w-002-9803).

CHURCH PLAN STATUS

A church plan is generally an employee benefit plan the establishment and administration of which is closely associated with a denominational church and that benefits employees working for (or deemed to work for) that church.

CHURCH PLAN DEFINED

A church plan is generally defined as a plan established and maintained for its employees by a church that is exempt from tax under Code Section 501 (ERISA § 3(33)(A) (29 U.S.C. § 1002(33)(A)) and 26 U.S.C. § 414(e)(1)). A church plan can also be established and maintained by a convention or association of churches. A convention of churches is a statewide, regional, or national group of churches of the same denomination that engage in cooperative efforts. An association of churches is a group of churches organized on less than a statewide level and can include churches of different denominations, if the governing board consists of representatives from each church.

ERISA Section 3(33)(C) further expands the definition of church plan to include a plan maintained by an organization that satisfies two conditions:

- Its principal purpose or function is the administration or funding of a retirement or welfare plan for church employees.
- It is "controlled by" or "associated with" a church (see When is an Organization Controlled by or Associated with a Church).

(29 U.S.C. § 1002(33)(C) and 26 U.S.C. § 414(e)(3).)

The expanded definition of church plan includes organizations, such as church benefit boards or retirement committees put in place solely for the purpose of administering the plan. However, recent litigation has questioned whether the statutory language permits these other organizations to maintain a church plan (see Church Plan Status Litigation).

Determining Whether an Organization is a Church

The term church is not defined by ERISA, the Code, or the related regulations. According to the courts and Internal Revenue Service (IRS), churches are a subset of organizations organized and operated for religious purposes and may include religious orders and religious organizations.

A religious order is treated as a church only if it is principally engaged in religious activities. A religious order is not treated as a church if it is eligible for tax-exempt status on other than religious grounds based on its principal activity (*De La Salle Institute v. U.S.*, 195 F. Supp. 891 (N.D. Cal. 1961)).

Whether a religious organization qualifies as a church is fact-specific. In determining whether a religious organization is a church for income tax purposes, the IRS considers factors including whether the organization has the following:

- Distinct legal existence.
- Recognized creed and form of worship. A recognized creed is a statement of faith or summary of beliefs. A form of worship includes religious practices that express the organization's devotion to its creed, faith, or beliefs.
- Definite and distinct ecclesiastical government. These include people or institutions that exercise significant influence or authority over the organization.
- Formal code of doctrine and discipline. This refers to a body of laws or rules that govern behavior, such as baptisms, weddings, funerals, and other religious rites.
- Distinct religious history. This is the story of the organization's establishment and major events in its past.
- Whether membership is associated with any other church or denomination.
- Organization of ordained ministers.
- Whether ordained ministers are selected only after completing prescribed courses of study.
- Literature of its own. This includes any writings about the organization's beliefs, rules, or history.
- Established places of worship. This is the place where an organization holds regularly scheduled religious services, which may be owned, rented, or provided freely for the organization's use.
- Regular congregations. This includes individuals regularly attending and taking part in the religious services of the organization at an established location. In certain contexts, the IRS requests an explanation of actions required for individuals to become members and the rights and benefits of members.
- Regular religious services. In certain contexts, the IRS asks the organization to disclose the regular days and times of religious services, describe the order of events during the regular worship service, explain how the activities conducted as part of the organization's services further its religious purposes, include copies of church bulletins, pamphlets, or flyers that are distributed to members or the general public and disclose the number of members and non-members regularly attending services.
- Sunday schools for the religious instruction of the young. This includes regularly scheduled religious, educational activities for youth.
- Schools for the preparation of its ministers. This may include formal or informal training, but does not include self-ordination.

(IRS Manual, Section 7.26.2.2.4.)

Although the IRS and the courts have stated that no one factor is controlling, they have generally found the existence of an established congregation served by an organized ministry, a membership not associated with any other church or denomination, regular religious services, the religious instruction of the young, and a formal code of doctrine and discipline to be important considerations (see *Am. Guidance Found., Inc. v. U.S.*, 490 F. Supp. 304 (D.D.C. 1980), *De La Salle Inst. v. U.S.*, 195 F. Supp. 891 (N.D. Cal. 1961), and *Chapman v. Comm'r*, 48 T.C. 358 (1967)).

Religious organizations that are not churches typically include:

- Nondenominational ministries.
- Interdenominational and ecumenical organizations.
- Other entities whose principal purpose is the study or advancement of religion.

(IRS Pub. 1828.)

Treasury Regulation Section 1.414(e)-1(e) provides that a religious order or a religious organization is also a church if it is both:

- An integral part of a church.
- Engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise.

Whether a religious order or a religious organization is an integral part of a church depends on the degree to which it is connected with and controlled by the church. Factors include:

- The extent of the organization's financial, legal, and liturgical responsibilities to the church.
- Whether the organization accepts the constitution and ecclesiastical law of the church.

(IRS PLR 9521033.)

A religious order or a religious organization is considered to be engaged in carrying out the functions of a church if its duties include:

- The ministration of sacerdotal functions.
- The conduct of religious worship.

(26 C.F.R. § 1.511-2(a)(3)(ii).)

Participants Must be Church Employees

Substantially all of the participants in a church plan must be employees of the church. An employee of a church includes:

- A duly ordained, commissioned, or licensed minister of a church in the exercise of the minister's ministry, regardless of the source of the minister's income, including self-employed ministers and chaplains employed by the military or for-profit organizations, such as a for-profit hospital or prison.
- An employee of a tax-exempt organization that is controlled by or associated with a church, such as a university or hospital.

(ERISA § 3(33)(B) and (C) (29 U.S.C. § 1002(33)(B) and (C)) and 26 U.S.C. § 414(e)(3)(B).)

A plan that is established and maintained primarily for the benefit of employees employed in connection with one or more unrelated trades or businesses cannot qualify as a church plan (ERISA § 3(33)(B)(i) (29 U.S.C. § 1002(33)(B)(i)) and 26 U.S.C. § 414(e)(2)).

When is an Organization Controlled by or Associated with a Church

A plan can qualify as a church plan even if it is not established and maintained by a church or convention or association of churches if it is instead maintained by an organization the principal purpose of which is to fund or administer a retirement plan for the employees of a church or convention or association of churches, if that organization is "controlled by" or "associated with" a church or convention or association of churches. The "organization" for this purpose may be a church benefit board or retirement committee that has administration of the plan as its principal purpose.

(ERISA § 3(33)(C) (29 U.S.C. § 1002(33)(C)) and 26 U.S.C. § 414(e)(3).)

Being a religious charity without being controlled by or associated with a church is not sufficient for a charity's plans to qualify as church plans (*Chronister v. Baptist Health*, 442 F.3d 648 (8th Cir. 2006)).

An organization is controlled by a church if a majority of its officers or directors are appointed by the church's governing board or by officials of a church. When determining whether an organization is controlled by a church, the IRS has considered certain factors including:

- Whether the church has the power to appoint and remove officers or members of the organization's board.
- Whether the organization's articles of incorporation or by-laws provide that some or all of the officers or board members are limited to members of the church.
- Whether the church approves the budget of the organization.

((26 C.F.R. § 1.414(e)-1(d)(2)), PLR 200708090 (Feb. 23, 2007), PLR 200514025 (Jan. 10, 2005), PLR 200436013 (Sept. 3, 2004), PLR 200323048 (June 6, 2003)).

These factors are also often important in the IRS's determination of whether the organization is associated with a church.

An organization is associated with a church if it shares common religious bonds and convictions with the church (ERISA § 3(33)(C)(iv) (29 U.S.C. § 1002(33)(C)(iv)) and 26 U.S.C. § 414(e)(3)(D)). The Department of Labor (DOL) has interpreted this to mean that, under the facts and circumstances, the organization adheres to the tenants and teachings of the church (DOL Adv. Op. 94-34A).

When determining whether an organization is associated with a church, the IRS has considered certain factors including whether the organization:

- Operates under church principles or under articles of incorporation and by-laws that require the organization to incorporate in its policies and practices the moral teachings of the church.
- Carries out the functions of the church, has a mission parallel to the church, or sponsors activities designed to support the religious mission of the church.
- Employs a chaplain or maintains a chapel where services and sacraments are conducted.
- Requires or offers religious instruction or a religious curriculum.
- Requires written verification from employees or students of their agreement to abide by the religious directives of the church.
- Receives significant financial support from the church.
- Grants preferential admission status to members of the church or practices preferential hiring of church members for faculty positions.
- Is organized exclusively for charitable or religious purposes.
- Enrolls a significant number of student members of the church, involves a majority of church members in its operations, or has a majority of church members on its board.
- Operates under by-laws or articles of incorporation that grant the church an official role in the governance of the organization or an influence concerning the direction of the organization.
- Provides for a reversion of its assets to the church if the organization is dissolved.

(See PLR 201333024 (May 22, 2013), PLR 201322051 (Mar. 8, 2013), and PLR 201308033 (Nov. 26, 2012).

The DOL defers to the IRS on church plan determinations, but also reviews the underlying IRS determination, generally considering the same factors. (Adv. Op. 1994-04A (January 17, 1994); Adv. Op. 1995-10A (June 16, 1995); Adv. Op. 2004-11A (December 30, 2004); Joint Committee on Employee Benefits Q&A for Department of Labor, May 10, 2000).)

While this analysis is fact-sensitive, the IRS has given particular weight to the factors regarding board control and financial support. The IRS has also frequently found that the listing of an organization in an official church directory is a significant, but not determinative, factor.

Church Plan Status Litigation

For more than 30 years, the IRS has issued private letter rulings (PLRs) finding that plans established and maintained by an organization controlled by or associated with a church were church plans. A significant number of recent lawsuits have challenged the IRS's traditional interpretation of ERISA Section 3(33)(C)(i) and Code Section 414(e)(3). These lawsuits assert that a church plan must be established by a church regardless of whether it is maintained by a church or church-related organization.

Under this interpretation, a hospital or university, for example, cannot establish a church plan even if it is controlled by or associated with a church. The Third, Seventh, and Ninth Circuit Courts of Appeal endorsed this interpretation when they each ruled in favor of plan participants who challenged the church plan status of their respective plans (see *Kaplan v. Saint Peter's Healthcare Sys.*, 810 F.3d 175 (3d Cir. 2015), *Stapleton v. Advocate Health Care Network*, 817 F.3d 517 (7th Cir. 2016), and *Rollins v. Dignity Health*, 830 F.3d 900 (9th Cir. 2016)).

In *Advocate Health Care Network v. Stapleton*, the US Supreme Court reversed the judgments of the Courts of Appeal and held that ERISA Section 3(33)(C)(i) expanded the definition of church plan to include a plan maintained by a church-related organization (referred to by the court as a principal-purpose organization), regardless of whether a church established the plan (Nos. 16-74, 16-86, 16-258, 2017 WL 2407476 (June 5, 2017)) (see Legal Update, Supreme Court: ERISA's Church Plan Exemption Includes Plans Maintained by Church-Affiliated Organizations (w-008-4747)). However, the Court did not address when an organization is considered to be a principal-purpose organization; that is, under what circumstances the administration of a plan is the organization's principal purpose. The Court also did not address the degree of control or association with a church that a principal-purpose organization must demonstrate to maintain a church plan. Therefore, litigation in the church plan context is likely to continue until these additional issues are resolved.

RULINGS ON CHURCH PLAN STATUS

Although not required, a church may request a PLR from the IRS stating that a plan is a church plan under Code Section 414(e). The general procedures for obtaining a PLR apply to these requests. The requesting church must also give written notice to all participants, beneficiaries, and participating employers that the church is requesting a ruling on church plan status. The notice must disclose the ERISA and Code provisions that do not apply to the plan due to its church plan status (Rev. Proc. 2011-44).

A church may also request an advisory opinion from the DOL stating that a plan is a church plan under ERISA Section 3(33). The DOL generally requires that the church first secure a favorable PLR on church plan status from the IRS. While the DOL defers to the IRS regarding its determination, the DOL reserves the right to independently review the determination. (Adv. Op. 2004-11A (December 30, 2004); Joint Committee on Employee Benefits, Q&A for the Department of Labor (May 10, 2000).)

CORRECTIONS FOR CHURCH PLAN FAILURES

If a church plan fails to satisfy one or more of the requirements to qualify as a church plan, the failure may be corrected both prospectively and retroactively if the correction is timely made. A correction is timely made if it is made before the latest of:

- 270 days after the IRS notifies the plan of a failure under Code Section 414(e).
- Either:
  - any period set by a court after a final determination that the plan fails to meet the requirements; or
  - if the court does not specify a period, any reasonable period determined by the IRS based on all of the facts and circumstances, but in no event less than 270 days after the determination has become final.
- Any additional period that the IRS determines is reasonable or necessary for the correction of the default.

(ERISA § 3(33)(D) (29 U.S.C. § 1002(33)(D)) and 26 U.S.C. § 414(e)(4).)

For example, if an organization that is controlled by or associated with a church fails to establish a retirement committee the principal purpose of which is to administer the organization's retirement plan, then the organization must establish the retirement committee within this correction period.

If a correction is not made within the correction period, the plan is not treated as a church plan and cannot later become a church plan.

ELECTING AND NON-ELECTING CHURCH PLANS

An administrator of a church plan may make an irrevocable election under Code Section 410(d) for ERISA and certain Code provisions to apply as if the plan were not a church plan (ERISA § 4(b)(2) (29 U.S.C. § 1003(b)(2)) and 26 C.F.R. § 1.410(d)-1). Although 410(d) elections are rare, a church plan may want to make this election to secure ERISA preemption of state laws or PBGC insurance coverage.

To make a 410(d) election, a plan administrator must either:

- Attach a written statement to the Form 5500 it files for the first plan year for which the election is to be effective.
- For a qualified 401(a) plan, attach a written statement to the determination letter application relating to the qualification of the plan.

In either case, the statement must indicate that:

- A 410(d) election is being made.
- The first plan year for which the election is being made.

(26 C.F.R. § 1.410(d)-1(c).)

If the church plan is a qualified defined benefit plan, the plan administrator must also notify the PBGC of its election for PBGC termination insurance to apply (ERISA § 4021(b)(3) (29 U.S.C. § 1321(b)(3)).

The IRS has historically taken the position that a 410(d) election cannot be made inadvertently, such as by including ERISA language in plan documents or by filing a Form 5500 without an attached written statement affirmatively electing ERISA coverage. However, once made, a 410(d) election is irrevocable. An election may also be conditioned upon issuance of a favorable determination letter and will become irrevocable when the determination letter is issued (26 C.F.R. § 1.410(d)-1(c)(4)).

While the DOL has indicated that a church health plan cannot make a 410(d) election for ERISA's provisions to apply, several courts have held otherwise (see DOL Adv. Op. 95-07A, DOL Adv. Op. 95-10A, *Catholic Charities of Me. v. City of Portland*, 304 F.Supp.2d 77, 89 (D. Me. 2004), *Robinson v. Metro. Life Ins. Co.*, 2013 WL 1281868, *5-11 (E.D. Cal. Mar. 27, 2013), and *Medellin v. Cmty. Care HMO, Inc.*, 787 F. Supp. 2d 1259, 1264-66 (N.D. Okla. 2011)).

The IRS and the courts have also disagreed about whether an employer can make a 410(d) election on a plan by plan basis, for example for its health plan and not for its retirement plan. While the IRS has indicated informally that a plan-by-plan election is not available, at least one court has recognized this election (*Flynn v. Ascension Health Long Term Disability Plan*, 73 F. Supp. 3d 1080 (E.D. Mo. 2014)).

Church plans that do not elect to have certain Code and ERISA provisions apply are sometimes referred to as "non-electing" church plans.

TYPES OF CHURCH RETIREMENT PLANS

A church retirement plan can be a:

- Defined benefit plan.
- Defined contribution plan (including a 401(k) cash or deferred arrangement).

- Code Section 403(b) plan (see Practice Note, Code Section 403(b) Plans: Overview (w-001-4400)).
- Code Section 457 plan.
- Nonqualified deferred compensation plan.

The rules that apply to a church retirement plan may depend on whether the church plan is maintained by a church or by an organization that is controlled by or associated with a church.

QUALIFIED CHURCH PLANS

A church retirement plan that is a qualified plan (also called a 401(a) plan) must have a written plan document and a formal trust. It can be in the form of either a defined benefit or defined contribution plan. If it is a defined contribution plan, it can be a profit sharing plan, including a 401(k) cash or deferred arrangement or money purchase pension plan. A non-electing 401(a) church plan is not subject to certain rules that otherwise apply to qualified plans, including:

- Minimum participation rules (26 U.S.C. § 410(c)(1)(B)).
- Minimum coverage requirements (26 U.S.C. § 410(c)(1)(B). Instead, pre-ERISA coverage rules under former Code Section 401(a)(3) apply to church plans. These rules generally require the plan to benefit at least 70% of all employees or at least 80% of all eligible employees if at least 70% of all employees are eligible to benefit under the plan. Certain employees can be excluded from service, including employees:
  - not meeting the plan's minimum service requirement;
  - not employed with the employer for more than five months during the year; or
  - generally not working more than 20 hours a week.

Alternatively, the IRS must find the eligible employee classification to not be discriminatory in favor of officers, shareholders, supervisors, or highly compensated employees (HCEs). A church plan can also satisfy the pre-ERISA coverage rules if it satisfies the current Code Section 410(b) coverage rules (26 C.F.R. § 1.410(b)-2(e)).

- Minimum vesting requirements, including the minimum vesting schedules, minimum accrual requirements for defined benefit plans, consent requirements for distributions, and the anti-cutback rule (26 U.S.C. § 411(e)(1)(B)). Pre-ERISA vesting rules under Code Sections 401(a)(4) and (7) apply to church plans (26 U.S.C. § 411(e)(2)). These rules generally require the plan to vest affected employees at normal retirement age, upon plan termination or partial termination, or upon complete discontinuance of contributions. The IRS has issued guidance regarding the requirement that employees vest at normal retirement age, as well as safe harbor vesting schedules that satisfy this requirement. (April 30, 2012 Memorandum for Manager, EP Determinations; see also Rev. Rul. 80-276; IRS Publication 778, Guides for Qualification of Pension, Profit-Sharing, and Stock Bonus Plans (obsoleted 4/1/1988)).
- Joint and survivor annuity rules (26 U.S.C. §§ 401(a)(11) and 417).
- Requirements relating to mergers and transfers of plan assets and liabilities (26 U.S.C. §§ 401(a)(12) and 414(l)).
- Anti-assignment rules, including the qualified domestic relation order (QDRO) rules of Code Section 414(p) (26 U.S.C. § 401(a)(13)). However, a distribution is treated as made pursuant to a QDRO if made pursuant to a domestic relations order meeting the requirements of Code Section 414(p)(1)(A)(i).
- Benefit commencement requirements (26 U.S.C. § 401(a)(14)).
- Protections relating to the reduction of benefits due to increases in Social Security benefits (26 U.S.C. § 401(a)(15)).
- Rules regarding forfeiture of benefits on withdrawal of mandatory employee contributions (26 U.S.C. § 401(a)(19)).
- Rules for qualified total distributions from a terminating plan (26 U.S.C. § 401(a)(20)).
- If the plan is a defined benefit or money purchase plan, the minimum funding rules (26 U.S.C. § 412).
- Certain prohibited transaction rules (26 U.S.C. § 4975).

(See Practice Note, Requirements for Qualified Retirement Plans (3-506-6895)).

A non-electing 401(a) church plan is subject to the remaining rules that apply to sponsors of 401(a) plans. These include:

- The exclusive benefit rule (26 U.S.C. § 401(a)(2)).
- Certain prohibited transaction rules (26 U.S.C. § 503(a)).
- Nondiscrimination rules. Unlike Code Section 403(b) church plans, there is no exception from the nondiscrimination rules for 401(a) church plans.

However, IRS Notice 2001-46 provides that church plans must comply only with a good faith, reasonable interpretation of the regulations under Code Sections 401(a)(4), 401(a)(5), 401(l), and 414(s) until further notice.

CODE SECTION 403(B) CHURCH PLANS

Only an eligible employer can establish a Code Section 403(b) plan (403(b) plan). An eligible employer includes an employer exempt from tax under Code Section 501(c)(3), such as a church or other religious or charitable organization. An eligible employer may also include:

- An employer of a self-employed minister or a chaplain performing services in the exercise of minister's or chaplain's ministry, but only with respect to that minister or chaplain.
- A self-employed minister providing services in the exercise of the minister's ministry, but only regarding a Code Section 403(b)(9) retirement income account.

(26 C.F.R. § 1.403(b)-2(b)(8)(i).)

A church or a church-related organization can establish a 403(b) plan by either:

- Purchasing an annuity contract.
- Establishing a custodial account that invests in mutual funds.
- Establishing or maintaining a retirement income account under Code Section 403(b)(9). A retirement income account is not required to invest in mutual funds or an annuity contract, but it may do so.

(26 U.S.C. §§ 403(b)(1), (7), and (9).)

A retirement income account must be designated as a 403(b)(9) plan in its written plan document and is generally treated the same as an annuity contract. However, a retirement income accounts is subject to several special rules, including that:

- The account must have a separate accounting for the account's interest in the underlying assets at all times.
- Investment performance must be based on the gains and losses on the underlying assets.
- The account's assets must satisfy the exclusive benefit rule.

(26 C.F.R. § 1.403(b)-9(a).)

A retirement income account is permitted to self-annuitize benefits if the distribution has a present value at the annuity starting date equal to the account balance based on reasonable actuarial assumptions and the plan sponsor guarantees the benefits. Annuity payments are treated as satisfying the required minimum distribution rules even though they are not paid through an annuity contract (26 C.F.R. §§ 1.403(b)-6(e)(5) and 1.403(b)-9(a)(5)).

For certain purposes under Code Section 403(b), the definition of the term "church plan" is narrower than under ERISA Section 3(33) and Code Section 414(e). For example, for purposes of the written plan document requirement and application of the nondiscrimination rules, a "church" is defined under Code Section 3121(w)(3)(A) to mean a church, a convention or association of churches, or an elementary or secondary school which is controlled, operated, or principally supported by a church or by a convention or association of churches. A qualified church-controlled organization (QCCO) is a church-controlled tax-exempt organization under Code Section 501(c)(3) other than an organization which:

- Offers goods, services, or facilities for sale, other than on an incidental basis, to the general public.
- Normally receives more than 25% of its support from either these sales or governmental sources, or both.

(26 U.S.C. § 3121(w)(3)(B).)

An organization that falls within the exclusion described above is a non-QCCO. Examples of non-QCCOs include hospitals, colleges or universities, and retirement homes that are controlled by or associated with a church.

Effective January 1, 2009, a written plan document is required under Code Section 403(b). The written plan document requirement does not apply to a 403(b) plan sponsored by a church or QCCO within the meaning of Code Section 3121(w)(3), unless it is a 403(b)(9) retirement income account. (Treas. Reg. § 1.403(b)-3(b)(3)(iii); Treas. Reg. § 1.403(b)-9(a)(2)(ii).) However, the written plan document does apply to a 403(b) plan sponsored by a non-QCCO.

Nondiscrimination rules, including the universal availability rule and the Code Section 410(b) coverage rule, do not apply to a 403(b) church plan established and maintained by church or a QCCO within the meaning of Code Section 3121(w)(3) (26 U.S.C. §§ 403(b)(1)(D) and 26 C.F.R. § 1.403(b)-5(d)). However, nondiscrimination rules do apply to a 403(b) church plan established and maintained by a non-QCCO.

No vesting or participation rules apply to non-electing church 403(b) plans because those rules apply to 403(b) plans by application of ERISA and ERISA does not apply.

While a 403(b) plan must generally be a defined contribution plan, certain defined benefit 403(b) plans established by a church or church-related organization before September 3, 1982, were grandfathered under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Legislation effective December 18, 2015, retroactively amended the 403(b) regulations to provide that the Code Section 415(b) limits, not the Code Section 415(c) limits, apply to defined benefit 403(b) plans.

CHURCH NONQUALIFIED DEFERRED COMPENSATION PLANS

Code Section 457 Plans for Non-QCCOs

Code Section 457 (26 U.S.C. § 457) governs the nonqualified deferred compensation plans of state governmental and tax-exempt employers. It specifically exempts churches and QCCOs from the definition of an eligible employer that can establish a Code Section 457 plan (457 plan). As a result, Code Section 457 applies only to the nonqualified deferred compensation plans established by a non-QCCO.

457 plans have fewer tax advantages than a qualified 401(a) or 403(b) plan, including that contributions (employer and employee) are subject to employment taxes at the time of vesting (IRS Notice 2003-20).

A non-QCCO can establish an "eligible" deferred compensation plan under Code Section 457(b). In exchange for compliance with specified limits on contributions and other restrictions, contributions to the 457(b) plan (and the earnings on those contributions) are not included in income taxes until paid or made available to participants (26 C.F.R. § 1.457-7(c)). It is important to recognize that non-QCCOs are subject to the rules under Code Section 457 that apply to tax-exempt employers, which are less advantageous to participants than those that apply to governmental employers. For example, a 457(b) plan sponsored by a non-QCCO must be unfunded, except that the non-QCCO can set aside contributions in a rabbi trust subject to the employer's general creditors without creating a funded arrangement (for a model rabbi trust agreement, see Standard Document, Model Rabbi Trust Agreement (8-513-4509)). Unlike other tax-exempt employers sponsoring a 457(b) plan, however, because ERISA does not apply to a non-electing church plan, a non-QCCO does not have to limit eligibility under the 457(b) plan to a select group of highly compensated or management employees. In other words, a 457 plan sponsored by a non-QCCO can be made broadly available to employees.

If a non-QCCO establishes a deferred compensation arrangement that does not satisfy the rules under Code Section 457(b) (and is not a 401(a) or 403(b) plan or otherwise treated as not providing for a deferral of compensation) then the arrangement is an "ineligible" deferred compensation plan under Code Section 457(f) (457(f) plan) (26 C.F.R. § 1.457-11). Amounts deferred under a 457(f) plan are generally taxable the year in which there is no longer a substantial risk of forfeiture with respect to such compensation, even if the amounts are not distributed until a later year. Compensation is subject to a substantial risk of forfeiture if the employee's rights to the compensation are conditioned on the future performance of substantial services (26 U.S.C. § 457(f)(3)(B)).

In other words, if there is no substantial risk of forfeiture at the time that the compensation is deferred, the present value of the compensation is taxed as current compensation (see Legal Update, IRS Proposes Rules Under Section 457 for Deferred Compensation Arrangements Maintained by Tax Exempt Organizations (w-002-6926)).

Code Section 409A, which sets out specific rules that deferred compensation arrangements must satisfy to avoid early taxation and sanctions, also applies to a 457(f) plan. However, a 457(f) plan can be designed to meet an exception from 409A, called the "short-term deferral" exception, if the compensation and earnings under the 457(f) plan are taxed shortly after the substantial risk of forfeiture lapses (see Practice Note, Section 409A: Deferred Compensation Tax Rules: Overview: Short-Term Deferral Exception (6-501-2009)). Under proposed Code Section 457 regulations, if an arrangement satisfies this short-term deferral exception, it cannot be treated as a deferral of compensation under Code Section 457(f) either (see Legal Update, IRS Proposes Rules Under Section 457 for Deferred Compensation Arrangements Maintained by Tax Exempt Organizations: Short-Term Deferral (w-002-6926)).

Nonqualified Deferred Compensation Plan for Churches and QCCOs

Because churches and QCCOs are exempt from Code Section 457, a nonqualified deferred compensation arrangement sponsored by these employers is governed by the same constructive receipt rules and the economic benefit rules that also apply to for-profit employers. As long as it is unfunded, a nonqualified deferred compensation arrangement can be structured so that it is not taxable until actually paid. To afford some protection to participants, however, a church or QCCO can put aside funds in a rabbi trust, which will not be treated as funded because those amounts are subject to the employer's general creditors (Rev. Proc. 92-64; see Standard Document, Model Rabbi Trust Agreement (8-513-4509)).

Nonqualified deferred compensation plans are subject to Code Section 409A and must be in writing and satisfy the 409A regulations to avoid early taxation and sanctions (see Practice Note, Section 409A: Deferred Compensation Tax Rules: Overview) (6-501-2009).

Application of State Laws

Because church plans are not subject to ERISA, state laws, such as laws relating to fiduciary responsibility or employment, contract, or insurance law, are not preempted and may apply to church retirement plans. For example, because wage laws in many states prevent wage reductions without affirmative employee consent, many churches do not provide for automatic enrollment in their retirement plans. However, effective December 18, 2015, church plans are permitted to automatically enroll employees in retirement plans if certain requirements are met and any state wage laws that otherwise prohibit enrollment are preempted (see Legal Update, Consolidated Appropriations Act of 2016 Postpones Cadillac Tax and Permanently Extends Transit Benefit Parity: Church Plans Clarification (w-001-1015)).

SELF-EMPLOYED MINISTERS AND CHAPLAINS

A self-employed minister providing services in the exercise of the minister's ministry can participate in a 401(a) plan established by the minister's employer based on the minister's earned income for the year (26 U.S.C. §§ 401(c) and 414(e)(5)). A chaplain can also participate in a 401(a) plan established by the chaplain's employer, on the same basis as any other employee.

A self-employed minister providing services in the exercise of the minister's ministry can participate in a Code Section 403(b)(9) income retirement account. For purposes of Code Section 403(b), a self-employed minister is treated as employed by the minister's own employer that is a tax-exempt organization under Code Section 501(c)(3) (26 U.S.C. §§ 403(b) and 414(e)). A self-employed minister's includible compensation is based on the minister's net earnings from self-employment, rather than the amount of compensation received from the employer. Contributions to a retirement income account are deductible to the extent provided under Code Section 404(a)(10) (26 U.S.C. § 404(a)(10) Treas. Reg. § 1.403(b)-9(c)).

Ministers employed by organizations that are not tax-exempt entities under Code Section 501(c)(3), such as a chaplain employed by a state-run prison, may also participate in a 403(b) plan to the extent that they are providing services in the exercise of their ministry (26 U.S.C. § 414(e)(5)(A)(i)).

An employer that does not sponsor a church plan may exclude a minister that provides ministerial services and participates in a church plan from being treated as an employee for purposes of applying the nondiscrimination rules regarding the employer's non-church plans. However, compensation taken into account for purposes of determining contributions or benefits under a church plan may not also be taken into account for purposes of determining contributions and benefits under a non-church plan (26 U.S.C. § 414(e)(5)(D)).

Any individual performing services for an eligible employer, such as self-employed ministers and other independent contractors, may participate in a 457 plan.

ALTERNATIVE RETIREMENT PLAN CONTRIBUTION LIMITS

A participant in a church plan may take advantage of certain modified limits to increase the amount of contributions the participant may make or have made on the participant's behalf to a qualified 401(a) or 403(b) plan.

Elective Deferrals to a 403(b) Plan – Special Catch-Up Contributions

A participant in a 401(k) plan or 403(b) may generally make elective deferrals to these plans up to the Code Section 402(g) limit ($18,000 for 2017) (Treas. Reg. § 1.403(b)-4(c)(1)). A participant who is at least age 50 by the end of the calendar year may also contribute an additional amount up to the Code Section 414(v) limit ($6,000 for 2017) (Treas. Reg. § 1.403(b)-4(c)(2)).

Additional elective deferrals of up to $3,000 in a calendar year (up to $15,000 during a lifetime), depending on the participant's total years of service and prior elective deferrals, may be made by:

- A minister with at least 15 years of service as a self-employed minister.
- An employee with at least 15 years of service with a church-related organization or an organization controlled by a church-related organization.

(26 C.F.R. § 1.403(b)-4(c)(3).)

For purposes of determining years of service and prior contributions, all entities are treated within the same denomination as a single employer.

For more information, see Practice Note, Code Section 403(b) Plans: Overview: Special Types of Contributions to 403(b) Plans (w-001-4400).

Annual Additions: Alternative 415(c) Limits for 403(b) Plans

Code Section 415(c) limits contributions to defined contribution 401(a) and 403(b) plans to the lesser of $54,000 (for 2017) or 100% of compensation (26 U.S.C. § 415(c)(3)(E)). Compensation for this purpose does not include a housing allowance, so an employee may not contribute the employee's entire salary if a housing allowance is declared on part of that salary. (Treas. Reg. § 1.403(b)-2(b)(11); PLR 200135045 (June 7, 2001); PLR 8416003 (Dec. 19, 1983).) However, a church plan participant's contribution limit may be higher than the general limit if an alternative limit applies.

For an employee employed by a church or a church-related organization, contributions can be made to a 403(b) plan up to $10,000 per calendar year regardless of compensation, up to $40,000 over the employee's lifetime (Treas. Reg. § 1.403(b)-9(b)). This special limit applies only to excesses over amounts that are permissible without regard to this rule. All years of service with a church or church-related organization are treated as employment with a single employer and all contributions are treated as contributed by a single employer (Treas. Reg. § 1.415(c)-1(d)(2)).

A second alternative Code Section 415(c) limit applies for employees performing services outside of the US for an employer that is a church or church-related organization, such as a foreign missionary. Contributions of up to $3,000 per calendar year can be made to a 403(b) plan without regard to compensation for these employees, provided the employee does not have adjusted gross income for the taxable year greater than $17,000. There is no lifetime limit on this alternative limit, and it does not reduce the $40,000 lifetime limit discussed above (Treas. Reg. § 1.415(c)-1(d)(3)).

Includible compensation for a foreign missionary also generally includes foreign earned income excluded under Code Section 911 (Treas. Reg. § 1.415(c)-2(g)(5)). An employer can make contributions to a retirement plan for foreign missionaries and treat them as if made by the missionary, so that the missionary has after-tax basis in the plan.

Annual Benefits – Modified Code Section 415(b) Limits

Code Section 415(b) limits the annual benefit that may be payable from a 401(a) or grandfathered 403(b)(9) defined benefit plan. The annual benefit generally cannot exceed the lesser of $215,000 (for 2017) or 100% of the average of the participant's highest three consecutive years of compensation. Under a special rule for church plans, the 415(b) limit does not apply until benefits are payable under the plan (Treas. Reg. § 1.415(b)-1(a)).

Effective January 1, 2007, the high three-year average compensation limit does not apply to a church plan sponsored by a church (but not a QCCO or non-QCCO), except for HCE benefits. HCE benefits include any accrued benefits for an employee in any year on or after which the employee is a HCE.

TRANSFERS AND MERGERS BETWEEN 401(A) AND 403(B) PLANS

Plan-to-plan transfers are generally permitted only between plans of the same type, for example, 403(b) plan to 403(b) plan or 401(a) plan to 401(a) plan. Effective December 18, 2015, tax-free transfers or mergers between 401(a) and 403(b) plans maintained by the same church, including a church-related organization, are permitted (26 U.S.C. § 414(z)(1)).

COMMINGLING ASSETS FOR INVESTMENT

For investment purposes, the assets of a 403(b)(9) retirement income account can be commingled in a common fund with other church assets devoted exclusively to church purposes if the part that equitably belongs to the retirement income account is separately accounted for and cannot be used for or diverted to any purpose other than the exclusive benefit of the employee (26 C.F.R. § 1.403(b)-9(a)(6)). Effective December 18, 2015, legislation clarified that a church plan can invest in a collective trust under Revenue Ruling 81-100, and that any other assets that can be commingled for investment purposes with that church plan can also be invested in the collective trust.

IRS DETERMINATIONS REGARDING TAX-ADVANTAGED STATUS

IRS Private Letter Rulings

Although an employer has historically been able to apply for a PLR regarding whether the form of the plan satisfies the requirements under 403(b), IRS Announcement 2009-89 provided that until further notice the IRS is no longer issuing PLRs for 403(b) plans beginning in 2010. However, a church plan sponsor may secure a PLR for its 457(b) plan (Rev. Proc. 98-40).

IRS Determination Letters

IRS determination letters are available only for 401(a) plans. A qualified church plan can generally apply for a determination letter regarding its qualified status under Code Section 401(a). However, effective as of January 1, 2017, the IRS has eliminated the five-year remedial amendment cycle system for individually designed plans and accepts determination letter applications for individually designed plans only for:

- Initial plan qualification.
- Qualification on plan termination.
- Other specified circumstances to be announced annually.

(See Legal Update, IRS Provides Determination Letter Guidance in Revenue Procedure 2016-37 (w-002-7353).)

As a result, an individually designed 401(a) church plan that has previously received a determination letter is generally unable to apply for another determination letter unless the plan is being terminated.

Pre-approved qualified plans continue to have a six-year remedial amendment cycle that allows employers that adopt pre-approved plans to apply for determination letters once every six years.

There is no determination letter process for 403(b) plans. According to Revenue Procedure 2013-22, the IRS does not intend to adopt such a process for 403(b) plans.

Pre-Approved Plans

Pre-approved plans are plan documents that have been approved by the IRS in form. A sponsor of a church plan can satisfy the written plan document requirement for qualified plans by adopting a pre-approved qualified plan. More recently, the IRS has established a program for securing pre-approval of 403(b) plan documents. A sponsor of a 403(b) church plan, including a retirement income account, can apply for pre-approval of its plan document under this program. Revenue Procedure 2013-22 sets out the process for securing pre-approval of a 403(b) plan (see Legal Update, IRS Establishes Program for Pre-approved 403(b) Plans in Revenue Procedure 2013-22 (4-525-5131)). To secure such a letter, sponsors must reasonably expect that the plan will be adopted by at least 30 employers, but this requirement does not apply to retirement income accounts.

WELFARE CHURCH PLANS

Church health and welfare plans are subject to most of the rules that apply to health and welfare plans sponsored by other types of employers. Although church health and welfare plans are exempt from many rules under ERISA and the Code, other legal requirements may still apply. For example, church plans must generally still comply with:

- Rules under the Affordable Care Act (ACA).
- The Health Insurance Portability and Accountability Act of 1996.
- Medicare Part D.

For more information on the legal requirements that apply to church health & welfare plans, see Practice Note, Church Plans: Health and Welfare Plan Compliance and Litigation (w-002-9803).

OTHER ISSUES

FORM 5500

Although Code Section 6058 generally requires plans to file a Form 5500, IRS Announcement 82-146 relieves church plans from the requirement to make Form 5500 filings.

CONTROLLED GROUP RULES

Many rules under the Code apply to all employers in the same controlled group on an aggregated basis, so it is important to determine if the employer sponsoring a church plan is required to be aggregated with any other employer. Previously, Treasury Regulation Section 1.414(c) stated that churches and QCCOs can be treated separately from non-QCCOs under the controlled group rules, and reserved application of the controlled group rules to churches and QCCOs. However, the treasury regulations required the aggregation of all non-QCCOs controlled by the same denominational church. This rule was unworkable for many non-QCCOs that had no relationship with one another other than that they were controlled by the same church. New legislation effective December 18, 2015 clarifies application of the controlled group rules to churches, QCCOs, and non-QCCOs. This legislation retroactively amends Code Section 414(c) to set out a general rule that any organization eligible to participate in a church plan (whether a church, QCCO, or non-QCCO) is not aggregated with any other organization unless:

- One of the organizations provides, either directly or indirectly, at least 80% of the operating funds for the other organization.
- The degree of common management or supervision between the organizations is such that the organization providing the operating funds is directly involved in the day-to-day operations of the other organization.

(26 U.S.C. § 414(c)(2) and Pub. L. No. 114-113, Div. Q, § 336(a).)

The legislation also provides that a non-QCCO is in the same controlled group as another non-QCCO or other organization, if at least 80% of the directors or trustees of the second organization are either representatives of or directly or indirectly controlled by the first organization.

HOUSING ALLOWANCE

Code Section 107 provides that in the case of a "minister of the gospel," gross income does not include a housing allowance paid to the minister as part of compensation, to the extent that the allowance:

- Is used by the minister to rent or provide a home.
- Does not exceed the fair rental value of the home.

(26 U.S.C. § 107.)

The housing allowance must be provided as remuneration for services which are ordinarily the duties of a minister of the gospel, which specifically include:

- The performance of sacerdotal functions.
- The conduct of religious worship.
- The administration and maintenance of religious organizations and their integral agencies.
- The performance of teaching and administrative duties at theological seminaries.

(26 C.F.R. § 1.107-1(a).)

Compensation must be designated as a housing allowance by the employing church or other qualified organization in advance of the payment.

Revenue Ruling 63-156 extended the housing allowance exclusion to retired ministers. Therefore, a retired minister of the gospel can designate a housing allowance on the minister's pension as compensation for the minister's past services that were in the exercise of ministry. The board of a denominational church plan is a "qualified organization" that can designate a portion of a retired minister's pension payments as a housing allowance. A church that sponsors its own retirement program for ministers may also designate a portion of the distributions paid to retired ministers as a housing allowance (Rev. Rul. 75-22).

SECURITY LAWS

Church plans are exempt from federal and state security laws, including the:

- Investment Company Act of 1940 (ICA).
- Securities Act of 1933 (Securities Act).
- Securities Exchange Act of 1934 (Exchange Act).
- Investment Advisers Act of 1940 (Advisers Act).

Accordingly, church plans are not required to register or report as investment companies, register securities held, or disclose information about the securities they hold. However, church plans are subject to notice and disclosure requirements, as well as the anti-fraud provisions of federal securities laws.

SELF-EMPLOYMENT TAX

For purposes of Social Security, ministers are treated as self-employed regarding their services in the exercise of their ministry (26 U.S.C. § 3121(b)(8)(A)). Accordingly, regardless of whether treated as an employee for purposes of income taxes, ministers pay self-employment taxes rather than Social Security and Medicare taxes. However, distributions from a church retirement plan to a minister following the minister's retirement are not subject to self-employment tax (26 U.S.C. § 1402(a)(8)).

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