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Proposed Tax Bill Would Ease Compliance for §403(b)(9) Plans of Religiously Affiliated Charities

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INTRODUCTION

On December 20, 2018, the House passed the Retirement, Savings, and Other Tax Relief Act of 2018 (H.R. 88).[1] The bill contains corrections to some provisions in the 2017 tax act[2] and certain other tax legislation. Whether the bill will pass in the Senate is yet to be determined.

H.R. 88 contains a welcome provision for employees of tax-exempt organizations affiliated with religious institutions who are participants in retirement or welfare benefit plans.[3] The bill would amend §403(b)(9) related to the benefit plans of religious and certain other organizations.[4] The proposed amendment would modify the definition of ''retirement income account'' for church plans by adding the following bracketed language in §403(b)(9)(B):

> ''(B) RETIREMENT INCOME ACCOUNT. – For purposes of this paragraph, the term ''retirement income account'' means a defined contribution program established or maintained by a church, or a convention or association of churches, including an organization described in §414(e)(3)(A), to provide benefits under §403(b) for an employee described in paragraph (1) **[including an employee described in section 414(e)(3)(B)]** or his beneficiaries.[5]

The bill said the provision ''shall apply to years beginning before, on, or after the date of the enactment of this Act.''[6]

Presently, tax-exempt affiliates of religious organizations must comply with complex requirements set forth in Treasury regulations and IRS guidance for sponsoring tax-deferred §403(b) retirement plans for their employees. But church plans, a special kind of a §403(b) plan, are exempt from some of these requirements, including the population of employees and compensation levels that the plan must cover. The rights of affiliates to provide these benefits without engaging a retirement board recently have been attacked in litigation but adjudicated favorably by the Supreme Court. The proposed amendment would clarify that §403(b)(9) retirement income accounts would cover certain employees of church-affiliated organizations, including a ''duly ordained, commissioned or licensed minister in the exercise of his or her ministry, regardless of the source of his or her compensation.''[7]

The amendment would end controversy regarding affiliate nonprofits sponsoring church plans for their employees and ministers through internal benefits committees. In this manner, the amendment would decrease the compliance and risk management burden for religious-affiliated charities. Reduced compliance and risk management costs would enable the affiliates to commit more funds to their religious, educational, and charitable causes, as well as toward employer re-

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[1] H.R. 88, Rules Comm. Print 115-87 (Dec. 20, 2018).

[2] Pub. L. No. 115-97.

[3] Division A, H.R. 88.

[4] H.R. 88 §208(a). Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (Code), or the Treasury regulations thereunder.

[5] H.R. 88 §208(a), Rules Comm. Print 115-87, at 122 – 123 (Nov. 26, 2018).

[6] *See* H.R. 88 §208(b).

[7] Ways and Means Committee, H.R. 88, Section-by-Section Summary 7 (Comm. Print Nov. 28, 2018).

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tirement contributions. In addition, a suggested modification to proposed legislation would deliver certainty to exempt affiliates of religious organizations and confirm 30 years of IRS guidance and legislative history supporting the exemption of such plan sponsors from §403(b) plan nondiscrimination requirements.

For some nonprofits affiliated with religious organizations, nondiscrimination testing to ensure compliance with §403(b) rules may be prohibitively expensive or otherwise a disincentive to sponsor the retirement program. Ability to offer church plan benefits at their discretion would reward high-performing or long-term employees and may incentivize other employees to increase the value of their services to the religiously affiliated employer.

Likewise, §403(b)(9) benefits offered as a reward for exceptional performance may encourage employees of religiously affiliated exempts to dedicate their careers to the nonprofit sector. In this manner, nonprofits with ties to religious institutions would gain an advantage in competing for talent with the private sector, instead of spending grant dollars defending the right to provide the retirement pay.

EXECUTIVE SUMMARY

This article addresses whether a not-for-profit organization under §501(c)(3) may sponsor a church plan to provide benefits to its employees, including ministerial employees, that would generally be exempt from the Code and Employee Retirement Income Security Act (ERISA) participation, vesting, funding, and fiduciary standards.[8]

This article also addresses whether a tax-exempt organization may administer the church plan through an internal benefits committee. In particular, the article addresses specific concerns of tax-exempt organizations affiliated with organizations of lay religions. For instance, in Judaism, there is no central ecclesiastical organization that confers ministerial authority in a hierarchical manner, and thus no control by a central religious organization. The article concludes that the proposed amendment in H.R. 88 would ease compliance concerns for such organizations and that additional conforming language may clarify legislative history exempting a §403(b)(9) plan sponsored by a charity affiliated with a lay religion from nondiscrimination rules.

First, the article provides a brief overview of regulatory exemptions under the Code and ERISA applicable to tax-exempt religious organizations or affiliates of religious organizations, referred to under the Code generally as ''churches.'' Second, the article analyzes §403(b)(9) and §414(e)(3)(A) and related IRS guidance governing whether a §501(c)(3) nonprofit organization affiliated with a religious organization may sponsor a church plan for its employees administered by an internal benefits committee.

Third, the article discusses the status of an affiliated charity as a church plan sponsor and the status of an internal benefits committee of the charity as the church plan administrator following a Supreme Court decision in 2017.[9] Finally, the article discusses how the proposed amendment in H.R. 88 would change the requirements for sponsorship or administration of a §403(b)(9) plan by an affiliated charity.

The article concludes that a modified amendment to §403(b)(9) would accomplish more definitively the legislative objective of codifying 30 years of IRS guidance, prior legislative history, and recent Supreme Court jurisprudence sanctioning tax-exempt organizations affiliated with religious institutions as sponsors and internal employee benefits committees as administrators of §403(b)(9) plans exempt from §403(b) nondiscrimination rules.

REQUIREMENTS OF §403(b) PLANS

A §403(b) plan is a retirement plan, contributions to which are eligible for tax-deferred treatment, and under which a public school, a §501(c)(3) organization, or a self-employed minister[10] purchases one or more annuity contracts or contributes to custodial accounts for its employees or the minister.[11] Section 403(b) plans are specifically exempted from the requirements applicable to qualified annuities under §403(a).[12] Section 403(b) plans are also generally known as tax-sheltered annuities, tax-deferred annuities, or annuity contracts.[13]

Section 403(b) plans may be funded through an employee's salary reduction contributions, by employer nonelective contributions, or by employee

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[8] ERISA, Pub. L. No. 93-406, 88 Stat. 829 §1 et seq. (1976). *But see* §403(b)(9) (applying certain requirements under §403(b) to §403(b)(9) ''church plans''); PLR 9415016 (''The general requirements for Code section 403(b) arrangements are made applicable to section 403(b)(9) arrangements pursuant to section 403(b)(9)(A)(i)'').

[9] *Advocate Health Care Network v. Stapleton*, 137 S. Ct. 1652 (2017).

[10] *See* §1402(a)(8), §1402(c)(4).

[11] *See* §403(b)(1)(A); Reg. §1.403(b)-1.

[12] *See generally* §403(a) (taxability of employee annuities), §404(a)(2)(deductibility by employer of contributions toward purchase of employee annuities meeting the specific requirements under §401(a) and §401(d)).

[13] *See* §403(b)(1); 1995 EO CPE Text.

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elective deferrals.[14] These funds may be invested in annuity contracts, mutual funds, and, in the case of §403(b)(9) ''church plans,'' retirement income accounts.[15] Contributions to §403(b) plans generally are tax-deferred.[16] Distributions of accrued principal and income from the retirement account to an employee or beneficiary generally commence on retirement or other separation from service.[17] An employee or beneficiary under the plan pays income tax on actual distributions of principal and earnings, which may be made as a lump sum or an annuity,[18] under §72 governing taxation of annuities.[19]

TAX EXEMPTIONS FOR 'CHURCHES' AND AFFILIATED ORGANIZATIONS

Section 501(c)(3) exempts certain religious, charitable, scientific, and other types of not-for-profit organizations from income tax under §501(a). Section 6033(a) exempts certain organizations, including ''churches, their integrated auxiliaries, and conventions, or associations of churches,'' from filing annual information returns on Form 990.[20] In addition, §170(b)(1)(A)(i) generally allows a deduction for charitable contributions to religious organizations, subject to an income limitation.

Definition of Religious Organizations Under §3121(w)(3)(A)

Section 414(e)(3) defines ''church plans'' that are exempt ''retirement income accounts'' under §403(b)(9),[21] but does not directly define the term ''church.''[22] Treasury regulations provide that a church for purposes of §414(e) includes ''a religious order or a religious organization if such order or organization (1) is an integral part of a church, and (2) is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise.''[23] This definition applies to determine whether a plan is established and maintained by a church or organization, the principal purpose of which is the administration or funding of a plan or program for the provision of retirement or welfare benefits.[24]

A §414(e) church plan is a §403(b)(9) plan exempt from ERISA or certain rules applicable to other §403(b) plans.[25] The §414(e) definition of a church means that affiliates described in §414(e)(3)(B)(ii) that are not integral parts of a church would not be church plan sponsors. However, as discussed in detail below, it is unnecessary for a church to be a sponsor to qualify for §403(b)(9) church plan treatment because under §414(e)(3)(A), a church plan may be administered by a committee, which only has to be associated with a church, by virtue of the association of the parent exempt organization.[26]

By contrast, for purposes of §403(b), the term ''church'' refers to a religious organization described in §3121(w)(3)(A) and includes ''qualified church-controlled organizations'' described in §3121(w)(3)(B).[27] Section 3121(w)(3)(A) defines a ''church'' circularly as 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.'' Section 3121(w)(1) permits churches and ''qualified church-controlled organizations'' to elect to exempt compensation paid to employees from employment taxes.

Qualified 'Church-Controlled' Affiliates Under §3121(w)(3)(B)

Section 3121(w)(3)(B) defines ''qualified church-controlled organizations'' as ''any church-controlled tax-exempt organization described in §501(c)(3), other than an organization that: (1) offers goods, services, or facilities for sale, other than on an incidental

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[14] *See* §403(b)(1); Reg. §1.403(b)-4(b), §1.403(b)-4(c)(setting forth contribution limitations for various types of deferrals under §403(b) annuity contracts).

[15] §403(b)(7), §403(b)(9).

[16] §403(b)(1).

[17] §403(b)(11); Reg. §1.403(b)-6(b).

[18] *See* Reg. §1.403(b)-9(a)(5).

[19] *See generally* §72(a); §403(b)(1); Reg. §1.403(b)-7(a)(setting forth rules on taxation of distributions from §403(b) plans).

[20] §6033(a)(3)(A)(i); Reg. §1.6033-2(g), §1.6033-(2)(h)(exempting from annual reporting requirements, among other organizations, churches and integrated auxiliaries, as well as ''an exclusively religious activity of any religious order'').

[21] Reg. §1.403(b)-9(a)(2)(defining retirement income accounts); §1.403(b)-9(b)(setting forth inapplicability of general contribution limitation under §403(b), providing applicable contribution limitation as set forth in §415(c)(7)).

[22] *See* §414(e)(3)(A).

[23] Reg. §1.414(e)-1(e).

[24] *See* PLR 200747022 (ruling tax-exempt hospital and its other listed organizations are associated with a church, hospital employees are deemed employees of the church even though the hospital is not a church within the definition of §414(e), committee appointed by the hospital board to administer the defined benefit plan whose assets are managed by a separate retirement plan investment committee is a §414(e)(3)(A) principal-purpose organization, the hospital retirement plan is a church plan).

[25] *See* Reg. §1.403(b)-9.

[26] §414(e)(3)(A); *see* PLR 200747022.

[27] §403(b)(12)(B); Reg. §1.403(b)-2(b)(5). *See* Reg. §1.403(b)-5(a)(nondiscrimination rules for contributions to §403(b) accounts, other than elective deferrals); Reg. 1.403(b)-5(d)(nondiscrimination rules not applicable to a §403(b) contract ''purchased by a church (as defined in 1.403(b)-2)'').

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basis, to the general public, other than goods, services, or facilities which are sold at a nominal charge which is substantially less than the cost of providing such goods, services, or facilities; and (2) normally receives more than 25% of its support from either governmental sources, or receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in activities which are not unrelated trades or businesses, or both.''[28]

Other Religious Faiths Included—Jewish Organizations and Affiliates

Religious organizations described in §3121(w)(3) are not limited to churches or church conventions or associations. For example, Orthodox Jewish organizations, which would qualify under §3121(w)(3)(A), include, among other institutions, orthodox synagogues or ''shuls'' as places of religious worship and ''kollelim'' as places of religious learning. Elementary or secondary schools of orthodox Jewish faith under §3121(w)(3)(A), or ''mosdos'' include ''yeshivos'' for boys or ''beis yaakov'' schools for girls.

However, in Judaism, as a lay religion there is no religious hierarchy to establish control of entities described in §3121(w)(3)(B). As the Tax Court opined in *Salkov v. Commissioner*, ''In a religious discipline having the lay democratic character of Judaism and lacking any central ecclesiastical organization, this ministerial authority can be conferred by the church or congregation itself.''[29]

Therefore, the description of organizations in §3121(w)(3)(B) on its face may not be applicable to charitable organizations of Jewish faith. Tax-exempt institutions affiliated with Jewish religious organizations described in §3121(w)(3)(A) more properly would be characterized as being associated with a religious organization within the meaning of §414(e)(3)(B)(ii)[30] and §414(e)(3)(D). Thus, there is an issue of whether they would be deemed as ''churches'' for purposes of the exemption from the nondiscrimination rules under §403(b)(1)(D).

Principal-Purpose Organizations and Tax-Exempt Employers in §414(e)(3)

Separately, §414(e)(3) describes two categories of organizations ''controlled by or associated with a church, or a convention or association of churches.'' The first category is a ''principal-purpose'' organization that maintains a church plan for employees of a church or a convention or association of churches.[31] The second category is an organization exempt from tax under §501 whose employees are eligible to participate in a church plan.[32]

Although §414(e) does not define an organization ''controlled by'' a church or a convention or association of churches,[33] the IRS has ruled that certain organizations may be deemed controlled by a church.[34] For instance, in PLR 8917012, the IRS ruled that a tax-exempt institution of higher education that was under the patronage and general direction of a religious organization was both controlled by and associated with the religious organization.

The IRS ruled that the employees of the educational institution were deemed church employees and that the appointive power of the religious organization provided it with control of the administrative committees of the educational institution. Thus, because the committees were organizations described in §414(e)(3)(A), the IRS ruled that the retirement and health insurance plans administered by the committees were §414(e) church plans.[35]

Under §414(e)(3)(D), an organization, whether a civil law corporation or otherwise, is associated with a ''church or a convention or association of churches'' if it shares common religious bonds and convictions with the religious institution.[36] The determination of whether a tax-exempt organization is associated with a religious organization, like the control determination, is based on the facts and circumstances.[37] For example, in PLR 201505048, a nonprofit providing

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[28] §3121(w)(3)(B).

[29] *Salkov v. Commissioner*, 46 T.C. 190, 196 (1966)(holding that in Judaism as a lay religion, there is no higher ecclesiastical body to confer ministerial authority; therefore, a Jewish cantor with formal training who performed sacerdotal functions was not self-appointed but instead was a minister commissioned and licensed by his congregation and by the cantorial body eligible for a parsonage allowance under §107(a)).

[30] The controlled or associated organizations in §414(e)(3)(B)(ii) are referenced interchangeably in this article as ''affiliated charity,'' ''affiliated organization,'' ''tax-exempt affiliate,'' ''tax-exempt affiliated organization,'' ''affiliated nonprofit,'' or similarly as legal context may require or for ease of discussion.

[31] §414(e)(3)(A).

[32] §414(e)(3)(B)(ii).

[33] *See* §414(e)(3); Reg. §1.403(b)-2(b)(6)(referring to organizations described in §414(e)(3)(A) as ''church-related'' organizations, not a term used in the statute).

[34] *See, e.g.*, PLR 9122078 (hospital under religious order was deemed controlled by and associated with church; employees of hospital were deemed employees of a church; plans administered by benefit plan committee with discretion and control over the administrative functions were church plans).

[35] PLR 8917012.

[36] *See, e.g.*, PLR 201505048.

[37] *See, e.g.*, PLR 8917012 (control by and association with a church); PLR 201505048 (association with a church). Religious organizations that are classified as churches, or conventions or associations of churches are referenced interchangeably in this article as religious organizations; religious institutions; churches; or churches, or conventions or associations of churches; or similarly

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residential living for needy adults or children sponsored retirement and welfare benefit plans for its employees administered by a benefits committee the nonprofit had created. The church listed the nonprofit in its directory and promotional materials, managed its funds, and members of the church were a majority of the members of the board of the nonprofit. The bylaws of the nonprofit provided that upon dissolution, the funds of the nonprofit would revert to the church and also included a statement of affiliation of the nonprofit with the church. Therefore, the IRS ruled the nonprofit was associated with the church, the employees were deemed employees of the church, the benefits committee was a principal-purpose organization, and the plans were church plans.[38]

Exemptions Under ERISA

Not-for-profit organizations may offer retirement benefits to their employees in the form of tax-advantaged or ''qualified'' retirement or welfare benefit plans.[39] Qualified retirement plans are subject to federal regulation under the joint jurisdiction of the Code and ERISA. The Code and ERISA contain participation and coverage, vesting, funding, and fiduciary responsibility standards applicable to qualified plans.[40]

Qualified plans, including §403(b) accounts, also are subject to Form 5500 reporting requirements under ERISA.[41] A §403(b)(9) plan may make an election to be subject to qualified plan rules under the Code and ERISA.[42] Absent that election, a §403(b)(9) retirement income account that is a ''church plan'' under §414(e)(3) and the parallel definition in ERISA §3(33)(A) would be exempt from these rules.[43]

AFFILIATED CHARITY AS CHURCH PLAN ADMINSTRATOR OR SPONSOR

Is the Affiliated Charity or Its Internal Committee a Principal-Purpose Organization?

Under §403(b)(9)(B), a ''retirement income account,'' or church plan, may be established or maintained by a church or a convention or association of churches, including a principal-purpose organization described in §414(e)(3)(A).[44] A principal-purpose organization must be ''an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, 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.''[45]

A §501(c)(3) exempt organization that is not a church within the meaning of §414(e)(3)(A) may be deemed to be controlled by or associated with a religious organization. However, a §501(c)(3) nonprofit must be organized and operated for one or more exempt purposes.[46] With some exceptions, such as the YMCA Retirement Fund[47] discussed below, administration or funding of a retirement plan for employees would not be a principal purpose of a not-for-profit §501(c)(3) organization.[48] Accordingly, in general, a charity on entity level, as opposed to an internal committee created by the charity, would not be the principal-purpose organization in §414(e)(3)(A).

The IRS in numerous rulings over the past 30 years has permitted an internal benefits committee of a §501(c)(3) nonprofit to function as a principal-purpose organization.[49] A church plan must meet the specific requirements under §403(b)(9) and §414(e) and Treasury regulations promulgated under §414(e).[50] The IRS required a tax-exempt affiliate to delegate all administrative functions with respect to

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as legal context may require or for ease of discussion.

[38] PLR 201505048.

[39] *See generally* §401(a) (qualified plan rules), §501(a)(exemption from income tax for an employee trust described in §401(a)).

[40] *See generally* §401(a), §410, §411, §412, §4975; ERISA tit. II, III, IV.

[41] *See* ERISA §103.

[42] §410(d).

[43] ERISA §4(b)(2), §3(33)(A).

[44] §403(b)(9)(B). *See also* Rev. Proc. 2011-44 (setting forth notice procedures to precede a PLR request for §403(b)(9) plan status).

[45] §414(e)(3)(A); *see* Reg. §1.403(b)-2(b)(5)(defining a ''church'' as an organization described in §3121(w)(3)).

[46] *See generally* §501(c)(3); Reg. §1.501(c)(3)-1 (organizational and operational tests applicable to §501(c)(3) charities).

[47] *See* 2017 Form 990, Young Men's Christian Association Retirement Fund.

[48] *But see, e.g.*, PLR. 8950086 (administrator of a church plan incorporated as a separate entity and exempt from tax under §501(c)(3)).

[49] *See, e.g.*, PLR 200510043 (church seminary committee to which the seminary delegated administration of plan is a principal-purpose organization within the meaning of §414(e)(3)(A), and the plan is a church plan within the meaning of §403(b)(9)). *Accord.* PLR 201505048 (benefits committee deemed a principal-purpose organization, church plan status); PLR 200043055 (plan administration committee of a hospital system deemed a principal-purpose organization, church plan status); PLR 8917012 (university plans deemed church plans); PLR 9122078 (plans of hospital under religious order administered by benefit plan committee deemed church plans); PLR 8950086; PLR 9835028.

[50] *See* §403(b), §414(e)(1)(A); *see, e.g.*, Reg. §1.414(e)-

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the plan to a benefits committee in order for it to qualify as a principal-purpose organization.[51] In addition, only active employees could participate in the plan administered by the committee.[52]

Is the Affiliated Charity an Employer or a Church Plan Sponsor Under §414(e)(3)?

Principal-Purpose Organization and Affiliated Charity Treated Separately

Employees of an affiliated tax-exempt organization may participate in a church plan sponsored by a church or a convention or association of churches and administered by a retirement board of the church or of a convention or association of churches.[53] Under §403(b)(9)(B), a church plan by definition may be established or maintained by a church or a convention or association of churches, ''including'' a principal-purpose organization.[54] However, under §414(e)(3)(A), when setting forth treatment of a plan as a church plan, only a plan ''maintained'' by a principal-purpose organization explicitly is treated as a church plan.[55]

Unlike a principal-purpose organization, an affiliated charity, whose employees are eligible church plan participants under §414(e)(3)(B)(ii), must be tax-exempt. Thus, there is a distinction in §414(e)(3) between a principal-purpose organization funding and administering the plan and an affiliated charity, which employs individual plan participants. Therefore, the two organizations may be separate entities. Section 414(e)(3)(A) is silent on whether an affiliated tax-exempt organization may establish or sponsor a church plan, akin to churches or conventions or associations of churches. Therefore, it is unclear whether employees of an affiliated charity may participate in a church plan sponsored by the charity.

Same Treatment of Contributions By Affiliated Charities or Church Employers

Section 403(b)(9)(A), the rule on treatment of contributions by an employer to a church plan, is silent on whether a tax-exempt employer may be the plan sponsor (which is similar to §414(e)(3)(A)). Section 403(b)(9)(A) states, ''amounts paid by an employer described in paragraph (1)(A) to a retirement income account shall be treated as amounts contributed by the employer for an annuity contract for the employee on whose behalf such account is maintained.'' Thus, like §403(b)(1), this provision references simply the religious and other §501(c)(3) organizations described in §403(b)(1)(A)(i), which are eligible to contribute to church plans on behalf of their employees. Therefore, §403(b)(9)(A) does not on its face preclude an affiliated charity from being a church plan sponsor.

'Retirement Income Account' Definition Silent on Affiliated Charity As Sponsor

Section 403(b)(9)(B) provides a retirement income account, or §403(b) church plan, is established or maintained by a church, or a convention or association of churches, including a principal-purpose organization, to provide benefits under §403(b) for an employee described in paragraph (1), or his beneficiary.[56] Thus, similarly to §403(b)(9)(A), §403(b)(9)(B) confirms that employees of a tax-exempt organization described in §403(b)(1)(A)(i)[57] may be church plan participants. But §403(b)(9)(B), like §403(b)(9)(A), is silent on an affiliated tax-exempt organization being a church plan sponsor.

Same Tax Consequences for Employees of Affiliated Charities or Churches

Consistently, §403(b)(1) setting forth the general rule for taxation of annuities to the employee states, in part, ''the contributions and other additions by such employer for such annuity contract shall be excluded from gross income of the employee.''[58] Thus, §403(b)(1) only confirms that an affiliated charity may be the employer. Section 403(b)(1) does not distinguish ability of an affiliated charity or a church to be a church plan sponsor.[59]

Contract Purchased By a Church; 'Established or Maintained' Requirement

The provisions in §403(b) and §414(e)(3) discussed above are either silent or supportive of church plan treatment of a §403(b) plan sponsored by an affiliated organization. But there are two provisions that, on the surface, may give a brief pause to this statutory interpretation. First, a church plan is exempt from nondis-

1(b)(2)(i)(A) (requirement of plan established primarily for employees who are not employed in connection with one or more unrelated trades or businesses applicable to non-grandfathered plans); PLR 9122078.

[51] *See, e.g.*, PLR 9835028.

[52] *See* PLR 201505048.

[53] §403(b)(1)(D), §403(b)(9)(B), §414(e)(3)(A).

[54] §403(b)(9)(B).

[55] §414(e)(3)(A).

[56] §403(b)(1), §403(b)(9)(B).

[57] Self-employed ministers also may participate in a church plan. *See* §403(b)(1)(A)(iii), §414(e)(3)(B)(i).

[58] §403(b)(1).

[59] *See* §403(b)(1)(A)(i) (including an annuity contract purchased ''for an employee by an employer described in §501(c)(3) which is exempt from tax under §501(a)'').

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crimination rules only to the extent the contract is purchased by a ''church,'' thereby subjecting some church plans to the nondiscrimination rules in §403(b)(12). Second, a church plan is ''established or maintained by'' a church or a convention or association of churches, including a principal-purpose organization, making it unclear whether an affiliated charity may establish the plan. These two ambiguities are resolved in the discussion below.

'Contract Purchased By a Church' Requirement in §403(b)(1)(D)

The exemption in §403(b)(1)(D) from §403(b)(12) nondiscrimination rules applies to ''a contract purchased by a church,'' not expressly inclusive of an affiliated charity. Section 403(b)(12)(B) defines a church for purposes of the exemption in §403(b)(1)(D) as an organization defined in §3121(w)(3)(A). Section 403(b)(12)(B) states further that a ''church'' in §403(b)(1)(D) includes a ''qualified church-controlled organization'' in §3121(w)(3)(B).

In 2004, Congress enacted legislation that generally designated any plan maintained by the YMCA Retirement Fund as a church plan maintained by a principal-purpose organization.[60] Such a plan would be deemed a retirement income account, or church plan, under §403(b)(9).[61] But a non-electing salary reduction arrangement maintained by the YMCA Retirement Fund was not a contract purchased by a church under §403(b)(1)(D).[62] The salary reduction arrangement also was not treated as a church plan for purposes of the alternative limitation on contributions to a defined contribution plan in §415(c)(7)(alternative contribution limit for contributions to defined contribution plans that are church plans).

The Bluebook prepared by the Joint Committee on Taxation (Joint Committee) stated, in part:

> ''the term 'church plan' includes a plan established or maintained by an organization: (1) that is controlled by or associated with a church and (2) the principal purpose or function of which is the administration or funding of a retirement or welfare benefit plan or program for church employees. Such organizations are referred to here as 'church-associated organizations.' ''[63]

Remarkably, the Joint Committee distinguished principal-purpose or affiliated tax-exempt organizations in §414(e)(3) from churches as plan sponsors:

> ''For purposes of the exemption from the nondiscrimination rules, church and church-controlled organization are defined as in section 3121(w)(3). This definition generally applies to a narrower class of organizations than the definition of church plan in section 414(e).''[64]

The YMCA Retirement Fund was a not-for-profit corporation established by a special act of the New York State legislature in 1921.[65] Thus, there was no church, convention, or affiliated charity establishing any of the plans maintained by the YMCA Retirement Fund. Instead, the YMCA Retirement Fund was a principal-purpose organization described in §414(e)(3)(A) maintaining, but perhaps not establishing, a retirement plan.[66] Accordingly, a YMCA Retirement Fund plan was not a contract purchased by a church under §403(b)(1)(D).

Self-Funded Church Plans Under §7702(j)

In the YMCA legislation, Congress required a contract to be ''purchased by a church'' under §403(b)(1)(D). However, Congress disregarded the requirement under §7702(j)(2) that a YMCA self-funded death benefit plan be ''provided by a church.''

Under §7702(j)(1), a church self-funded death benefit plan does not have to be a life insurance contract under §7702(a) if it meets the requirements of §7720(j)(2). A plan or arrangement qualifies under §7702(j)(2) if, in part, it is ''provided by a church for the benefit of its employees and their beneficiaries, directly or through an organization described in §414(e)(3)(A) or an organization described in §414(e)(3)(B)(ii).''[67] A church for these purposes is defined circularly as a ''church or a convention or association of churches.''[68]

The Joint Committee explained:

> ''For purposes of the definition of life insurance contract under the Code, a YMCA retirement plan is treated as an arrangement that provides for the

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[60] An Act to Treat Certain Arrangements Maintained By the YMCA Retirement Fund As Church Plans for Purposes of Certain Provisions of the Internal Revenue Code of 1986, and for Other Purposes, Pub. L. No. 108-476 §1(a)(1)(hereinafter, ''YMCA Retirement Fund Act''). *See* §414(e)(3)(A) (defining a principal-purpose organization).

[61] YMCA Retirement Fund Act, §1(a)(2)(B) (YMCA salary reduction arrangement), §1(a)(3)(C) (YMCA money purchase plan).

[62] YMCA Retirement Fund Act, §1(a)(2)(B); §403(b)(12).

[63] *General Explanation Of Tax Legislation Enacted In The 108th Congress*, J. Comm. Print 21-118 525 – 528 (May 2005) (hereinafter, ''2004 General Explanation'').

[64] *Id.* at 526, n.1069.

[65] *Id*. at 527.

[66] *See* YMCA Retirement Fund Act, §1(a)(1).

[67] §7702(j)(2)(B).

[68] *See* §3121(w)(3)(A), §7702(j)(3).

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payment of benefits by reason of the death of individuals covered under the arrangement and that is provided by a church for the benefit of its employees and their beneficiaries, directly or through a church-associated organization.''[69]

However, a YMCA Retirement Fund death benefit plan is not ''provided by a church.'' Rather, a YMCA Retirement Fund plan is provided through the Fund as a principal-purpose organization.

Moreover, the New York State Legislature, not a church, incorporated the YMCA Retirement Fund by legislative action in 1921.[70] Thus, the term ''purchased by a church'' was regarded for purposes of §403(b)(1)(D). But, the term ''provided by a church'' was superfluous with respect to a YMCA Retirement Fund arrangement under §7702(j)(2).

Congress may have used a broader definition of a church inclusive of principal-purpose or affiliate organizations in §414(e)(3)(A) for purposes of §7702(j)(2).[71] The definition of a ''church'' for the nondiscrimination exemption appeared narrower than the meaning in §414(e)(3)(A), as the Joint Committee noted.[72] But, as evident from legislative history of the Tax Reform Act of 1986, the narrow reading by the Joint Committee of the nondiscrimination exemption was misplaced.

Nondiscrimination Exemption for Affiliates in the Tax Reform Act of 1986

Qualified plans, in general, are subject to nondiscrimination rules requiring coverage of a certain percentage of employees of the sponsoring employer (the ''percentage test'') and not skewing toward highly compensated employees (the ''classification test'').[73] The prohibition on favoring highly compensated employees also applies to the contributions made or benefits provided under the plan.[74] Originally, tax-sheltered annuities under §403(b) were not subject to nondiscrimination rules.[75]

Congress, as part of the Tax Reform Act of 1986 (1986 Act), extended these rules to §403(b) plans, with the exception of church plans, codified in §403(b)(1)(D).[76] The Joint Committee explained the definition of employers sponsoring plans exempt from nondiscrimination rules in the Bluebook accompanying the 1986 Act, in part as follows:

> ''In addition, for purposes of the exemption from the coverage and nondiscrimination rules, congregationally organized churches or conventions or associations of churches generally are not to be treated differently than hierarchically organized churches or conventions or associations of churches in determining whether particular organizations are 'qualified church-controlled organizations.' Therefore, an organization will not fail to be treated as church-controlled if it is controlled by **or associated with** (within the meaning of section 414(e)(3)(D)) a church or convention or association of churches.''[77] (Emphasis supplied.)

Therefore, excluding affiliated organizations described in §414(e)(3)(B)(ii) and defined in §414(e)(3)(D) would have treated unequally affiliates of organizations of a faith that had no religious hierarchy to establish control under §3121(w)(3)(B). The Joint Committee reference to congregational organizations pointedly referred to affiliates of Jewish religious organizations, which the Tax Court had described as having no hierarchy.[78] Accordingly, contrary to the treatment of the YMCA Retirement Fund, a creature of a state legislature, the nondiscrimination exemption extends to affiliates of religious organizations described in §414(e)(3)(B)(ii) that sponsor §403(b)(9) plans.

Affiliate Included in Definition of 'Church' as Plan Sponsor Under TEFRA

Section 414(e)(3)(A) refers to a plan established or maintained ''for its employees (or their beneficia-

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[69] 2004 General Explanation, at 527.

[70] YMCA Retirement Fund, ''The Fund is a not-for-profit pension fund organized and operated for the purpose of providing retirement and other benefits for employees of YMCAs throughout the United States. It was incorporated by the Legislature of the State of New York by Enactment of Chapter 459 of the Laws of 1921, as amended.''

[71] *See* §414(e)(3)(A); 2004 General Explanation, at 526, n.1069.

[72] *See* §403(b)(1)(D), §403(b)(12)(B), §3121(w)(3)(generally limiting plan sponsors to churches and qualified church-controlled organizations). *Compare with* §414(e)(3)(A) (explicitly including principal-purpose organizations as church plan sponsors, and indirectly, affiliated tax-exempt entities).

[73] *See generally* §401(a)(4), §401(a)(5), §401(a)(26), §403(b)(12), §410; Reg. §1.403(b)-5 (2007) (applicable nondiscrimination rules for non-elective deferrals and employee elective deferrals under a §403(b) plan other than a contract purchased by a church).

[74] *See* §401(a)(4), §401(a)(5), §410; Reg. §1.403(b)-5(a)(1)(i) (2007) (applicability of nondiscrimination rules to contributions and benefits for non-elective deferrals under §403(b) plans that are not contracts purchased by a church), §1.403(b)-5(b)(2)(requiring notice of opportunity to make a cash or deferred election with respect to contributions made on behalf of employee to the §403(b) plan).

[75] *See* §403(b); General Explanation of the Tax Reform Act of 1986, J. Comm. Print 72-236 671 (1987) (hereinafter, ''1986 General Explanation'').

[76] Tax Reform Act of 1986, Pub. L. No. 99-514 §1120(a) (1986).

[77] *See* 1986 General Explanation, at 681 (discussing employers subject to the nondiscrimination rule).

[78] *See* n. 29, above.

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ries)'' by a church or a convention or association of churches, and includes a plan maintained by a principal-purpose organization ''for the employees of a church or a convention or association of churches.'' Employees of a church or a convention or association of churches, as discussed above, includes employees of an affiliated tax-exempt organization under §414(e)(3)(B)(ii).

Thus, a church or a convention or association of churches may establish or maintain a church plan for its employees. Equally, a principal-purpose organization may maintain a church plan for employees of an affiliated tax-exempt organization. The issue is whether an affiliated charity may ''establish'' a church plan for its employees exempt under §403(b)(1)(D).

The legislative history of §403(b) and §414(e)(3) demonstrate clearly that affiliated charities are included within the scope of eligible church plan sponsors. The church plan definition in §414(e) was amended in 1980 alongside its ERISA §3(33)(A) counterpart to include plans maintained by principal-purpose organizations.[79] Section 403(b)(9) was added by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and included plans established or maintained by principal-purpose organizations in §414(e)(3)(A).[80]

TEFRA §251(e)(5) provided a special rule for defined benefit plans treated as church plans under the amended §403(b). The rule said,

> ''(5) SPECIAL RULE FOR EXISTING DEFINED BENEFIT ARRANGEMENTS.—Any defined benefit arrangement which is established by a church or a convention or association of churches (**including an organization described in section 414(e)(3)(B)(ii)** of the Internal Revenue Code of 1954) and which is in effect on the date of the enactment of this Act shall not be treated as failing to meet the requirements of section 403(b)(2) of such Code merely because it is a defined benefit arrangement.''[81] (emphasis added)

In this manner, Congress included tax-exempt affiliated organizations described in predecessor §414(e)(3)(B)(ii) in the definition of a ''church or a convention or association of churches.''[82] Therefore, affiliated organizations, in the same way as churches, could establish or sponsor church plans.

TEFRA legislative history demonstrates unequivocally this legislative intent. The TEFRA Bluebook stated, in part,

> ''The Act revises the prior-law rules relating to tax-sheltered annuity programs maintained by churches for their employees by generally increasing the ability of churches to provide retirement income for their employees and by clarifying the status of such programs under the tax law. For purposes of the Act's provisions, **the term church includes a convention or association of churches, or an organization which is exempt from tax and is controlled by or associated with a church or a convention or association of churches**. Church employees include duly ordained, commissioned, or licensed ministers and lay employees, including employees of tax-exempt organizations (whether civil law corporations or otherwise organized) which are controlled by or associated with a church.''[83] (emphasis added)

Thus, the Joint Committee on Taxation referred to principal-purpose organizations described in §414(e)(3)(A) as tax-exempt employers described in §414(e)(3)(B)(ii). Therefore, tax-exempt affiliates were deemed as churches eligible to establish or maintain church plans under §414(e)(3)(A). Accordingly, §414(e)(3)(C) provided that a church or a convention or association of churches was the employer of an employee of a tax-exempt affiliate described in §414(e)(3)(B).

CHURCH PLAN OF AFFILIATED CHARITY UNDER ERISA JURISPRUDENCE

In *Advocate Health Care Network v. Stapleton*, the Supreme Court held that defined benefit plans maintained by internal benefits committees of church-affiliated hospital systems qualified as church plans.[84] The Court held that the ERISA definition of a church plan, the same as the definition in §414(e)(3), did not

[79] Multiemployer Pension Plan Act Amendments of 1980, Pub. L. No. 96-364 §407 (conforming amendments to church plan definition under ERISA §3(33)(A) and IRC §414(e) to include principal-purpose organizations, effective retroactively to Jan. 1, 1974, the effective date of ERISA). *See Advocate Health Care Network v. Stapleton*, 137 S. Ct. 1652, 1658 – 1659 (2017) (discussing legislative history of ERISA §3(33)(A)).

[80] Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248 §251(b)(hereinafter, TEFRA).

[81] TEFRA §251(e)(5). *See* Reg. §1.403(b)-10(f), *corrected by* 75 Fed. Reg. 65,566, 65,566 (Oct. 26, 2010) (permitting certain church defined benefit plans to be deemed as §403(b)(9) retirement income accounts pursuant to TEFRA).

[82] *See* §414(e)(3)(B)(ii).

[83] ''General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982'', 97th Cong., Pub. L. 97-248, J. Comm. Print (Dec. 31, 1982).

[84] A complete discussion of jurisprudence by lower federal courts in various jurisdictions interpreting ERISA requirements with respect to a church plan sponsor is outside the scope of this discussion.

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require a plan maintained by a principal-purpose organization, the benefits committee, to have been established by a church.[85] Essentially, the Court concluded that a plan maintained by a principal-purpose organization must not be established or maintained by a church.[86]

Rather, the ''established and maintained'' requirement is the original definition, the meeting of which yields the ERISA exemption.[87] In turn, a plan maintained by a principal-purpose organization is a new type of plan, separate from a plan ''established and maintained'' by a church.[88] This new type of plan was simply added under a 1980 statutory amendment to fall within the original definition, which went unchanged.[89]

The Court analyzed the legislative history of the church plan definition, including a 1980 amendment in response to objections by constituent groups that the Department of Labor had too much leeway to determine what constituted church activity.[90] Essentially, the legislative history analyzed in *Advocate Health Care* may not be conclusive of Congressional intent in 1980 legislation to extend church plan status beyond church retirement boards to affiliated tax-exempt organizations.[91] However, TEFRA §251 and accompanying legislative history would have obviated this analysis and been dispositive in demonstrating success on the merits of the appellants' arguments in *Advocate Health Care* in favor of church plan status.

CHURCH PLAN OF AFFILIATED CHARITY UNDER §208 of H.R. 88

Section 208 would add to §403(b)(9)(B) clarifying language that a plan established or maintained by a church, or a convention or association of churches, including a principal-purpose organization described in §414(e)(3)(A) provides benefits for employees described in §403(b)(1), including an employee described in §414(e)(3)(B). The proposed amendment accomplishes the following three objectives in permitting an affiliated charity that is not a church to sponsor a church plan for its employees using a benefits committee.

Elimination of "Deemed Employee" of a Church Status. First, as a result of adding affiliated charity employees within the scope of employees who benefit under a §403(b)(9) plan, employees of affiliated charities no longer have to qualify as deemed employees of a church. Instead, employees of affiliated charities are sanctioned to participate directly in a church plan sponsored by their tax-exempt employer and administered through a committee.

However, in practical terms, this result would not substantially alter the documentation requirements that must be followed by affiliated charities for church plan status. Under existing IRS guidance, affiliates have had to demonstrate control by or association with a religious organization by the charity and also by the administrative committee as the principal-purpose organization. In addition, the governing documents of the charity must demonstrate control of the administrative committee if the committee cannot independently demonstrate control by or association with a religious organization. Even under proposed changes, affiliated exempt organizations must continue to include appropriate language in their governing documents to memorialize the control relationship between the parent charity and the internal benefits committee.

Codifying an Internal Benefits Committee as a Principal-Purpose Organization. The proposed amendment would confirm that an administrative committee of an affiliated tax-exempt organization might serve as the principal-purpose organization maintaining a church plan sponsored by the tax-exempt parent entity. There is no mention of a committee in either §403(b)(9) or §414(e)(3)(A) as a principal-purpose entity. But if an affiliated charity sponsored a church plan, the committee necessarily would be a principal-purpose organization whose primary purpose is to provide plan benefits to employees in §414(e).

Confirming Tax-Exempt Affiliate as Church Plan Sponsor. Permitting a benefits committee of an affiliated organization to serve as church plan administrator and eliminating a required link between charity employees and church as employer dispels any doubt about an affiliated charity sponsoring a church plan for its employees. Thus, §208 of H.R. 88 codifies existing IRS guidance and federal case law under ERISA on the status of an affiliate as a church plan sponsor.

Additional Conforming Amendment

Section 208 of H.R. 88 may be modified to include in parentheses the phrase ''(including an organization

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[85] *See Advocate Health Care Network*, 137 S. Ct. at 1660, n.5 (reasoning that had Congress included ''established and maintained'' requirement for church plans run by principal-purpose organizations, Congress would have left out church plans initially established by a church but subsequently maintained by a principal-purpose organization; concluding that plans not initially established but subsequently administered by church retirement boards, which were intended by Congress to be covered by the statute, would have been excluded).

[86] *See id.* at 1658.

[87] *Id.*

[88] *Id.*

[89] *See id.* at 1658 – 1659.

[90] *See id.* at 1661 – 1662.

[91] *See id.* at 1658 – 1662.

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described in section 414(e)(3)(B)(ii))'' after ''church'' in §403(b)(1)(D). The conforming change would confirm that tax-exempt organizations without religious hierarchy, in the same way as entities that may be controlled by a church, are exempt from the costly nondiscrimination provisions in §403(b)(12). This conforming language would codify the statutory interpretation expressly stated in legislative history enacting the §403(b)(9) plan exemption from nondiscrimination rules.

CONCLUSION

Proposed amendments to §208 of H.R. 88 would clarify the scope of organizations and participants eligible for §403(b)(9) ''church plans,'' which are exempt from certain qualified plan rules under the Code and ERISA. The proposed amendments would also codify recent Supreme Court jurisprudence holding that charities affiliated with religious organizations may sponsor their own §403(b)(9) plans for their employees, including ministerial workers.

Likewise, the proposed amendments would codify the Supreme Court holding in *Advocate Health Care Network v. Stapleton* that an affiliated charity may administer its §403(b)(9) plan through an internal benefits committee meeting the ''principal-purpose organization'' requirement under §403(b)(9)(B) and §414(e)(3)(A).[92]

In this manner, the proposed amendments would incorporate IRS guidance over the past 30 years on the eligibility of plans under §403(b)(9) and recent federal jurisprudence regarding the exemption of church plans sponsored and maintained by affiliated charities from 403(b)(12) nondiscrimination rules or ERISA requirements.

Additional conforming language in §403(b)(1)(D) would confirm further that ministerial and other employees of a §501(c)(3) charity not classified as a ''church'' under the Code but associated with a religious institution may participate in a §403(b)(9) plan sponsored by the affiliated charity and administered by its benefits committee and exempt from the nondiscrimination requirements under §403(b)(12).

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[92] *Advocate Health Care Network*, 137 S. Ct. 1652.

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