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View From McDermott: The Church Plan Struggle as Litigation Unfolds



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Two federal courts have recently declared that defined benefit pension plans maintained by large Catholic health systems were not church plans. Another federal court, based on a very similar fact pattern to the other two, reached the opposite conclusion and upheld a Catholic health system's defined benefit pension plan as a church plan.

Church plans have historically been exempt from the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and many Internal Revenue Code of 1986, as amended (the "Code") provisions, most importantly requirements as to minimum levels of pension plan funding. Although one favorable decision has occurred, with two Catholic systems receiving adverse determinations on church plan status and two more deci-

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sions pending,¹ this article analyzes exactly what a loss of such church plan status may mean to similarly situated organizations depending how the five cases eventually evolve.

What is a Church Plan Anyway? Well . . . It Depends on Who You are Talking To . . .

ERISA imposes extensive requirements on most retirement plans but provides a special exception through ERISA § 3(33)(A) for a plan "established and maintained . . . for its employees (and their beneficiaries) by a church or convention or association of churches." Therefore, church plans are exempt from ERISA's funding, reporting and disclosure rules applying to employee pension plans. Since the 1980s, Internal Revenue Service ("IRS") and Department of Labor ("DOL") guidance (primarily in the form of rulings or opinions) has stated that a "church" itself does not need to establish the plan but if the plan itself, at all times, is maintained and administered by the church or by an organization controlled by or associated with the church, then a sufficient "church" connection existed to qualify for church plan status under ERISA § 3(33)(C). Historically, this connection has been most commonly demonstrated by a church-appointed and church-controlled committee having exclusive authority to control and manage the operation and administration of the church plan. For example, a religious order of the church would be considered the equivalent of a church, so long as the order was an integral part of the church and was engaged in carrying out the functions of the church.

With the first two federal decisions, the court in *Rollins v. Dignity Health* and the court in *Kaplan v. St. Peter's Healthcare* interpreted the application of ERISA § 3(33)(C) quite differently from the long-standing IRS and DOL guidance. Both of these courts concluded that although ERISA § 3(33)(C) permits church-associated organizations to maintain church plans, ERISA § 3(33)(A) still demands that *only a church may establish a church plan*. According to these courts, Congress

¹ The five main Catholic health system church plan cases include the following: *Overall v. Ascension Health*, *Chavies v. Catholic Health East*, *Medina v. Catholic Health Initiatives*, *Kaplan v. Saint Peter's Healthcare System*, and *Rollins v. Dignity Health*. As discussed below, the *Overall* court ruled that the Ascension Health Alliance plans were church plans.

intentionally did not use the word “establish” in the ERISA § 3(33)(C) provision because establishment by a church had to have been met before ERISA § 3(33)(C) could apply.

In contrast, in *Overall v. Ascension Health*, that court agreed with the prior IRS and DOL guidance and held that a church itself did not have to establish a church plan based on the 1980 changes to the statute. Specifically, the *Ascension* court noted that the change in statutory language in ERISA § 3(33)(C) in the 1980s expressly broadened the church plan exemption to include “organizations that were affiliated with churches, such as hospitals or schools.” It was noted that the language of ERISA § 3(33)(C) expressly stated that a church plan “includes a plan maintained by an organization. . . 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. . . if such organization is controlled by or associated with a church. . .” (emphasis added) In light of this, the *Ascension* court clearly interpreted the ERISA language as expanding the exemption and concluded that ERISA § 3(33)(A) was not the “gatekeeper” for ERISA § 3(33)(C).

Why Didn't the *Dignity* and *St. Peter's* Courts Give Any Deference to the Prior Governmental Rulings Issued to These Plans?

The federal district courts in those cases ruled that they were not obligated to give deference to any IRS or DOL “church plan” ruling previously issued to the underlying defined benefit pension plan. The *Dignity* court stated that “[n]either the courts nor the IRS may rely on letter rulings as precedent.” *Bankers Life & Cas. Co. v. United States* (1998). Notwithstanding this, the judge further expounded that “[t]he weight the court must give to the letters depends on the thoroughness evident in [their] consideration, the validity of [their] reasoning, [their] consistency with earlier and later pronouncements, and all those factors which give [them] power to persuade, if lacking power to control.” *Skidmore v. Swift & Co* (1944). When evaluating the prior rulings, the *Dignity* court did not give deference to the IRS letters, concluding that the IRS position “lacked any meaningful analysis,” as the IRS did not analyze the statute closely or evaluate how the language directly applied to the plan sponsor.

The *St. Peter's* court reached a similar conclusion in a slightly different manner. That court stated that ERISA is a remedial statute, so any exemptions included thereunder should be construed narrowly. *Rodriguez v. Compass Shipping* (1981). According to the *St. Peter's* court, the prior government rulings and court decisions often bypassed ERISA § 3(33)(A) of the definition and immediately applied ERISA § 3(33)(C), made conflicting determinations regarding the limitations of ERISA § 3(33)(C) or even misstated the text of ERISA § 3(33)(C) by saying a church plan was established OR maintained by a church instead of using the connector “and.” Finally, the *St. Peter's* court reiterated that Congressional silence, alone, in the wake of administrative rulings does not give the rulings the force of law. *Brown v. Gardner* (1994).

Why Did the *Ascension* Court Give Deference to the Prior Governmental Rulings Issued to The Plan?

The federal district court in the *Ascension* case stated that the IRS has followed its original conclusion of its rulings for more than 30 years. Accordingly, although IRS private letter rulings are not binding, the court believed they were entitled to deference, citing *United States v. Cleveland Indians Baseball Co.* (2001) (stating that an agency’s long-standing interpretation that is reasonable “attracts substantial judicial deference”). In this situation, the court concluded that the IRS’s interpretation was completely consistent with the text of the statute. Specifically, the *Ascension* court noted that if the IRS and DOL prior guidance had been incorrect, Congress had had 30 years to clarify that interpretation and had not bothered to, indicating that perhaps the IRS and DOL interpretation was accurate.

According to the *Dignity* and *St. Peter's* Courts, if the IRS and/or DOL Have Gotten it Wrong in a Prior Ruling, What Were the Courts to Do?

According to the *Dignity* and *St. Peter's* courts, the judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent. When interpreting a statute, a court “must give effect to the unambiguously express intent of Congress.” *Chevron v. Natural Res. Def. Council* (1984).

Both courts first analyzed whether ERISA § 3(33)(A) and ERISA § 3(33)(C) were ambiguous. Concluding they were not, both courts generally reached the conclusion that the plan sponsor’s interpretation emasculated the purpose of ERISA § 3(33)(A) entirely and such a reading, if applied consistently, would make ERISA § 3(33)(A) have no purpose. Additionally, the language of ERISA § 3(33)(A) is reiterated in ERISA § 3(33)(C) and therefore, according to each court, actively retained as a requirement (so therefore, Congress acted intentionally in using those precise words regarding “establishment”). The *St. Peter's* court specifically concluded that if the plan sponsor’s argument was correct, then any tax-exempt organization could establish its own pension plan, maintain it, and then employ the church plan exemption by purporting to be controlled by or associated with a church. The *St. Peter's* court could not conclude that Congress intended “to create this slippery slope.” The court succinctly summed its conclusion up by stating that “it is not [the court’s] task to assess the consequences of each approach and adopt the one that produces the least mischief. The charge is to give effect to the law Congress enacted.” As such, the final decision in both cases was that a “church plan” had to be established by a church.

What Do the Adverse Decisions of *Dignity* and *St. Peter's* Mean for Other Church Plan Sponsors?

As previously stated, there are now two adverse church plan decisions and one favorable church plan

decision, all issued by different federal district courts. As the next two Catholic health system church plan cases are decided, it is possible that the current three recent court rulings will be viewed as precedent even though occurring in different federal districts. The *St. Peter's* court specifically referred to the *Dignity* court's legal analysis in reaching its own conclusion. The *Ascension* court equally referred to the *Dignity* and *St. Peter's* courts' legal analysis in reaching its conclusion that those prior two decisions were incorrect. It is uncertain how the remaining two courts will decide the issue with inconsistent views expressed in three district courts. However, since the same plaintiff's law firm is pursuing all five cases, this controversy is unlikely to be resolved anytime soon, particularly with two favorable determinations for impacted plaintiffs.

As of today, there is no commentary yet from either the IRS or DOL directly addressing these court decisions and how those governmental agencies specifically intend to view the *St. Peter's* and *Dignity* decisions. Although the *Ascension* decision clearly supported prior church plan guidance, those agencies have now been told twice in two separate case decisions that their prior church plan analysis was flawed and inaccurate. This raises concerns among church plan sponsors with similar fact patterns as to how those unfavorable decisions will impact their underlying church plan ruling. Notwithstanding these rulings, they should not be viewed yet as a law change as it is inevitable that at least the two church plans currently impacted by adverse decisions will be looking to appeal the decisions (*Dignity's* request to immediately appeal the California district court's denial of the motion to dismiss has already been denied).

Under Revenue Procedure 2014-4, Section 13, a plan sponsor ordinarily may rely on a letter ruling received from the IRS subject to certain conditions and limitations. First, a plan sponsor may not rely on a letter ruling issued to another plan sponsor. Second, as the litigation surrounding church plans unfolds, if the IRS subsequently decides to change its position or conclusions on prior church plan rulings, a letter ruling found to be in error or not in accord with the current views of the IRS may be revoked or modified. However, if a letter ruling is revoked or modified, the revocation or modification applies to *all years open under the statute of limitations* unless the IRS uses its discretionary authority under Code § 7805(b) to limit the retroactive effect of the revocation or modification. This clarifies that a church plan established in 1960 that has an IRS ruling will NOT have to go back decades and correct prior pension computations.

A letter ruling may be revoked or modified due to: (1) a notice to the plan sponsor to whom the letter ruling was issued; (2) the enactment of legislation or ratification of a tax treaty; (3) a decision of the United States Supreme Court; (4) the issuance of temporary or final regulations; or (5) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin. Consistent with these provisions, if a letter ruling relates to a continuing action or a series of actions, it ordinarily will be applied until any one of the events described above occurs or until it is specifically withdrawn – meaning that the IRS historically does not look to apply changes in these situations retroactively. Therefore, with respect to any revocation or modification to letter rulings in the future

by the IRS, the IRS does not intend to detrimentally impact the plan sponsor directly involved in the letter ruling who acted in good faith in relying on the letter ruling. If a letter ruling is revoked or modified with retroactive effect, the letter will, except in fraud cases, state the grounds on which the letter ruling is being revoked or modified and explain the reasons why it is being revoked or modified retroactively.

The main take away here is that regardless of any change that may or may not happen as a result of current church plan litigation, current church plans with favorable private letter rulings may rely on their church plan ruling until: (1) the Supreme Court makes a final decision on the issue; (2) Congress changes the law; OR (3) the plan sponsor is specifically notified that the prior ruling is revoked. According to the above, UNTIL one of these things happen, a church plan with a ruling can continue to operate in good faith as church plan.

However, we would recommend that a tax-exempt organization maintaining a “church plan” that was not originally established by a “church” evaluate and understand the potential ramifications to their defined benefit pension plan of becoming an ERISA plan if the ultimate direction of the litigation continues in an unfavorable fashion for church plans. For example, specifically understanding the funding issues and how application of the various Code and ERISA requirements (e.g., dictated interest rates under Code § 417(e)(3)) will alter the funding level of their pension plan so that the organization is in an educated position to evaluate how to proceed should additional church plan decisions gain traction or alternatively, the IRS universally reverses its prior position. Understanding those types of revisions will assist an organization in evaluating with their legal counsel whether to freeze their pension plans today (to cease further accruals and funding levels) and perhaps migrate toward a defined contribution plan platform for purposes of providing retirement benefits. Because it is unclear how, and if, this issue will be resolved, organizations with fact situations similar to the church plan structures targeted in the litigation need to be knowledgeable in the event a wholesale change is made to the rules to which they are subject.

Application of Law to Defined Benefit Church Plans

In the event the *Dignity* and *St. Peter's* decisions are not overturned and similar decisions are reached in the other two church plan cases, the IRS and DOL will face pressure to reverse prior church plan rulings or opinions issued to retirement plans unless those retirement plans were truly “established by a church.” If and when the IRS and DOL reverse these prior positions, some “prior” church plans will no longer be exempt from ERISA. This means that these previously exempt defined benefit plans will be subject to the full scope of reporting and disclosures rules, including newly required coverage under the Pension Benefit Guaranty Corporation (“PBGC”) rules.

Further, any arrangements that may potentially lose church plan status would then be subject to the following Code provisions (from which they were exempt as a church plan):

■ Code Section 401(a)(11) (QJ&SA): *See the very last paragraph of Code Section 401(a).*

■ Code Section 401(a)(12) (Transfer of assets in corporate transaction): *See the very last paragraph of Code Section 401(a).*

■ Code Section 401(a)(13) (Assignment and alienation): *See the very last paragraph of Code Section 401(a).*

■ Code Section 401(a)(14) (Last day for benefits to commence): *See the very last paragraph of Code Section 401(a).*

■ Code Section 401(a)(15): *See the very last paragraph of Code Section 401(a).*

■ Code Section 401(a)(19): *See the very last paragraph of Code Section 401(a).*

■ Code Section 401(a)(20): *See the very last paragraph of Code Section 401(a).*

■ Code Section 410 (Minimum participation standards): *See Code Section 410(c)(1)(B).*

■ Code Section 411 (Minimum vesting standards): *See Code Section 411(e)(2).*

■ Code Section 412 (Minimum funding standards): *See Code Section 412(e)(2)(D).*

■ Code Section 417 (Minimum Survivor Annuity Requirements): *See the very last paragraph of Code Section 401(a) and the first sentence of Code Section 401(a)(11).*

■ Code Section 430 (Minimum Funding Standards): *See Code Section 412(e)(2)(D) and Code Section 412(a)(2)(A).* Since Code Section 412 does not apply, then neither do the rules of Code Section 430.

■ Code Section 436 (Funding Based Limits): *See Code Section 436(a) and Code Section 401(a)(29).* Pursuant to Code Section 401(a)(29), the requirements of Code Section 436 apply to pension arrangements to which Code Section 412 applies. Pursuant to Code Section 412(e)(2)(D), Code Section 412 does not apply to the Plan, and hence Code Section 436, by definition, does not apply either.

■ Code Section 4975. *See Code Section 4975(g)(3).* Such plans would also continue to be subject to Code Sections 401(a)(4), 401(k), 401(m), 414(s) and 415.

Conclusion

If the *Dignity* and *St. Peter's* court decisions stick and additional adverse church plan decisions are made against similarly situated plan sponsors, it is probable that the IRS and DOL will take compromise positions in prospectively getting those "converted" plans into compliance with the Code and ERISA. Notwithstanding this, organizations with fact patterns similar to *Dignity* and *St. Peter's* should consider what such a proposed transition would mean for their organization to better understand not only the legal impact but the financial impact.