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District Court Rules that Church Hospitals Cannot Establish Non-ERISA Church Plans

Background

As reported in prior Alerts (see http://www.groom.com/resources-800.html), for many years, prominent plaintiffs' law firms, working with the National Pension Rights Center, have been filing lawsuits seeking to limit the definition of church plan under ERISA to entities that are churches (thus excluding church-related entities). The goal of these lawsuits has been to subject the underfunded defined benefit church plans of such church-related entities to ERISA fiduciary requirements and PBGC insurance coverage. Prior litigation efforts have been unsuccessful. However, in 2013, well-known plaintiffs' firms filed five nearly identical lawsuits against church-based hospitals across the country. This was perceived as an effort to find at least one federal judge who would accept their arguments. They appear to have found one. In light of a recent decision by this federal judge, discussed in detail below, the risk has increased substantially that separately incorporated 501(c)(3) entities that are not actual churches (such as hospitals, schools, colleges, universities, nursing homes, thrift shops or other charities) cannot establish and maintain their own church plans (though they may be able to participate in denominational church plans). The decision's reasoning would not be limited to defined benefit pension plans – it would apply to any pension or welfare plan. Because few plans that are church plans will have complied with ERISA and the Code in every respect, the potential taxes, interest and penalties resulting from a finding of non-compliance for any given church-related charitable organization could be staggering.

The Decision

In Rollins v. Dignity Health, No. 13-01450 (N.D. Cal. Dec. 12, 2013), Judge Thelton Henderson entered an order denying a motion to dismiss by Dignity Health, a non-profit healthcare provider. The Court based its decision on its interpretation of the relevant statutory language of what constitutes a church plan under ERISA. Judge Henderson's construction of that definition is fundamentally at odds with all previous interpretations of the statutory language to date (including IRS and DOL rulings and opinions). The Court's analysis focuses on two sections of the statutory language (Section 3(33) of ERISA). The first part of the statute states:

> [t]he term 'church plan' means a plan *established and maintained ... by a church* or by a convention or association of churches which is exempt from tax under section 501...

The statute later states:

> a plan *established and maintained* ... by a church or by a convention or association of churches *includes* a plan *maintained by 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 or welfare benefits or both ... if such organization is controlled by or associated with a church or convention or association of churches...." (emphasis added.)

Previous courts and agencies have read this language to mean that if a plan is "maintained" by an organization controlled by or associated with a church, then it is considered "established and maintained by a church," since a plan "established and maintained by a church" "*includes*" plans "maintained" by such an organization. Rollins turns that reading on its head. Instead, Judge Henderson opined that under a "plain reading" of the statute, a plan must first be "established and maintained by a church," and only *after* a church has "established" the plan can an organization controlled by or associated with a church "maintain" the plan. To conclude otherwise, said the court, "would reflect a perfect example of an exception swallowing the rule".

The term "church," as used in this section of the statute, is not defined anywhere in the Code, ERISA, or either statute's implementing regulations. Nonetheless, the IRS has consistently applied a traditional definition of church as illustrated by the guidance enunciated in the Internal Revenue Manual. That definition looks to factors such as whether there is an established place of worship, regular congregation and regular services, schools for religious instruction of the young, and seminaries for clergy. (Because this would not describe most religious orders, e.g., an order of nuns, Treasury Regulations specifically provide that for church plan purposes, the term "church" also includes a religious order or a religious organization if such order or organization is an integral part of a church, and is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise.)

Judge Henderson acknowledged in his decision that every other court to have considered the question has determined that the plan in question qualified as a church plan. Still, Judge Henderson found each of these court decisions to be flawed and unconvincing. Judge Henderson also cited legislative history to the Multiemployer Pension Plan Amendments Act of 1980, which introduced the provision in question, as confirming his reading. Most practitioners, however, would be hard pressed to find the legislative history as particularly conclusive. Immediately after its enactment, everyone – proponents of the legislation, the drafters of the IRS and DOL ruling and opinion drafters, and practitioners working in the field – began interpreting the statute opposite to the judge's reading, and have been doing so for nearly 33 years.

One issue curiously missing from the decision is any discussion of the retroactive correction provision for church plan status in ERISA section 3(33)(D). That provision reads:

> [i]f a plan established and maintained for its employees ... by a church or by a convention or association of churches ... fails to meet one or more of the requirements of this paragraph [Section 3(33) of ERISA] and corrects its failure to meet such requirements within the correction period, the plan shall be deemed to meet the requirements of this paragraph for the year in which correction was made and for all prior years.

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The correction period referred to is generous, ending generally 270 days after the IRS or a court of competent jurisdiction makes a final determination that the plan fails to meet such requirements. Presumably, Rollins read the language to exclude from such relief plans that were not originally established by a church. It remains to be seen whether other Courts will take up this issue, or whether the religious orders or diocese involved in the litigation may assert that they established the plans in question or seek to apply the retroactive correction.

Potential Consequences of Rollins

It may be premature to assign too much importance to Rollins. The decision clearly is an outlier and seems certain to be appealed. Nonetheless, every separately incorporated 501(c)(3) entity controlled by or associated with a church that has its own plans, and treats them as church plans, should be concerned and should watch this development closely. The consequences stemming from Rollins could be enormous. Just having failed to file Form 5500s for church plans (welfare or retirement) could result in DOL penalties of $30,000 per return per year. Other consequences could include other DOL and IRS penalties (such as penalties for not having providing various required notices), Internal Revenue Code noncompliance consequences, and other possible results.

The income tax consequences in particular may present a problem. Many church plans will not have met the Internal Revenue Code qualification requirements applicable to non-church plans. Generally, a 401(a) plan once disqualified for tax purposes is a plan forever disqualified unless there is a closing agreement with the IRS, or a correction made under the Employee Plans Compliance Resolution System (which is not a simple process). Nonqualified plans face many tax consequences: Code section 402(b) provides rules for taxation of nonqualified trusts to participants and beneficiaries, there are rules for taxation of nonexempt trusts, and sections 457(f) and 409A impose harsh income tax consequences and penalties (largely on the employee) if nonqualified plans of nonprofit employers don't meet those Code provisions. The consequences are harsh for the employer, the trustee, and the participants and beneficiaries.

Finally, Rollins makes determining which entity originally established a church plan critical. This question could entrap even traditional denominational church plans. The Court concluded that the reference to church plans including plans maintained by church-associated organization "was only intended to permit church pension boards to administer church plans," and that "it was never contemplated to be so broad as to permit any church affiliated agency to start its own plan and qualify for ERISA exemption as a church plan." This means that, under Rollins, a denominational plan that was originally "established" by a church pension board or other agency, rather than by the church or convention or association of churches (or religious order) itself, would not qualify as a church plan and could be subject to ERISA.

Potential Legislative Solution

Rollins rests squarely on the statutory interpretation of church plan under ERISA. To address this, there may be an opportunity to mobilize support in Congress to clear up any ambiguity resulting from Rollins by amending the definition of church plan. As a Washington, D.C. based firm, we maintain valuable contacts on Capitol Hill and with senior officials at the IRS, DOL and the PBGC. The experience we have allows us an opportunity to work with legislators and their staffers as well as senior government officials on a level of mutual respect and with an eye to working towards a positive outcome for our clients.

Conclusion

All church plan sponsors would be advised to consider the implications of Rollins for their plans. To discuss the decision and ways to mitigate risks, please contact David Powell, Lars Golumbic or Steve Saxon.

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