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Church Plan Law Changes as Part of the Omnibus Budget Deal; Church 401(a)/403(b) Plan Transfers and Mergers Now Permitted

Section 336 of the Protecting Americans from Tax Hikes (PATH) Act (H.R. 2029), which was passed as part of the recent budget deal signed into law by President Obama on December 18, 2015, contains a number of significant provisions affecting church plans. Though generally technical and narrowly targeted in nature, they are nevertheless important to a number of church plans. As noted in the legislative history to the Act, none of this is intended to have, or appears to have, any impact on the ongoing litigation against church-related hospitals over the church plan definition. The legislative changes are summarized as follows:

1. Clarification of Controlled Group Rules to Church Plans. When the controlled group rules for nonprofits were issued a number of years ago (in Treas. Reg. section 1.414(c)-5), they addressed some aspects of the aggregation of plans of non-qualified church-controlled organizations (also known as "NQCCOs," generally church hospitals, colleges, universities and nursing homes) but otherwise generally reserved their application to churches and church-related organizations. The PATH Act adds further clarification in the form of a general rule that an organization that is otherwise eligible to participate in a church plan shall not be aggregated with another such organization and treated as a single employer with such other organization for a plan year beginning in a taxable year unless (i) one such organization provides (directly or indirectly) at least 80 percent of the operating funds for the other organization during the preceding taxable year of the recipient organization, and (ii) there is a degree of common management or supervision between the organizations such that the organization providing the operating funds is directly involved in the day-to-day operations of the other organization. However, two exceptions were also added:

> (a) NQCCOs shall be aggregated with one or more other NQCCOs, or with an organization that is not exempt from tax under section 501, and treated as a single employer with such other organization, only if at least 80 percent of the directors or trustees of such other organization are either representatives of, or directly or indirectly controlled by, such NQCCO. In other words, unless so related, such NQCCOs in a church plan would apply nondiscrimination rules each on their own, not on an aggregated basis.
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> (b) Second, a church or convention or association of churches with which an organization which has the principal purpose or function of the administration or funding of retirement or welfare benefits plans for church employees is associated, or an organization designated by such church or convention or association of churches, may elect to treat such organizations as a single employer for a plan year.

Such election, once made, shall apply to all succeeding plan years unless revoked with notice provided to the IRS in a manner to be prescribed. In addition, in the case of a church plan, an employer may elect to treat churches (i.e., churches and QCCOs) separately from entities that are not churches (e.g., NQCCOs), without regard to whether such entities maintain separate church plans.

These provisions are effective for plan years before, on, or after the date of the enactment of the Act.

2. 415 Rule for Grandfathered Defined Benefit 403(b)(9) Church Plans. Changing the current provision of the 415 regulations, the Act provides that grandfathered defined benefit church retirement income accounts under 403(b)(9) will be subject to the defined benefit limitations of Code section 415(b), and not the defined contribution limitations of Code section 415(c). This applies to years beginning before, on, or after the date of the enactment of the Act.

3. Automatic Enrollment by Church Plans. The Act allows church plans to have automatic contribution arrangements and supersedes any law of a State that relates to wage, salary, payroll payment, collection, deduction, garnishment, assignment, or withholding which would directly or indirectly prohibit or restrict the inclusion in any church plan of an automatic contribution arrangement. The plan sponsor of, or plan administrator or employer maintaining, the church plan automatic contribution arrangement shall, within a reasonable period before the first day of each plan year, provide to each participant to whom the arrangement applies for such plan year notice of the participant's rights and obligations under the arrangement. The Act provides for certain rules for the arrangement, the notice, and for provision of a default investment. This provision was effective upon enactment of the Act.

4. Plan-to-Plan Transfers Between Church 403(b) and Church 401(a) Plans. A new Code section 414(z) has been added by the Act which will permit tax-deferred transfers of all or a portion of the accrued benefit of a participant or beneficiary, whether or not vested, from a church plan that is a plan described in section 401(a) or an annuity contract described in section 403(b) (which includes 403(b)(7) custodial accounts and 403(b)(9) retirement income accounts) to an annuity contract described in section 403(b), if such plan and annuity contract are both maintained by the same church or convention or association of churches, and similarly from an annuity contract described in section 403(b) to a church plan that is a plan described in section 401(a), again if such plan and annuity contract are both maintained by the same church or convention or association of churches. The provision also permits a merger of a church plan that is a plan described in section 401(a), or an annuity contract described in section 403(b), with an annuity contract described in section 403(b), if such plan and annuity contract are both maintained by the same church or convention or association of churches. The participant's or beneficiary's total accrued benefit immediately after the transfer or merger must be equal to or greater than the participant's or beneficiary's total accrued benefit immediately before the transfer or merger, and such total accrued benefit must be nonforfeitable after the transfer or merger. In this case, the term "church or convention or association of churches" includes organizations the principal purpose of which is the administration or funding of retirement or welfare benefit plans for church employees, and 501(c)(3) entities controlled by or associated with a church or convention or association of churches. This new provision is applicable to transfers or mergers occurring after the date of enactment of the Act.

5. Clarification That Church Plans can Invest in a Group Trust. Though earlier legislation sought to clarify that church plans could invest in group trusts (see Public Law No. 112-142, the Church Plan Investment Clarification Act, signed on July 9, 2012) it apparently did not fully resolve the technical concerns of some securities lawyers on the issue. The Act has added a provision that in the case of a church plan, including a plan described in section 401(a) of the Code and a retirement income account described in section 403(b)(9) of such Code, and an organization described in section 414(e)(3)(A) of the Code the principal purpose or function of which is the administration of such a plan or account, the assets of such plan, account, or organization (including any assets otherwise permitted to be commingled for investment purposes with the assets of such a plan, account, or organization) may be invested in a

group trust otherwise described in Internal Revenue Service Revenue Ruling 81–100 (as modified by Internal Revenue Service Revenue Rulings 2004–67, 2011–1, and 2014–24), or any subsequent revenue ruling that supersedes or modifies such revenue ruling, without adversely affecting the tax status of the group trust, such plan, account, or organization, or any other plan or trust that invests in the group trust. This provision applies to investments made after the date of enactment of the Act.